

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

B R A Z I L

PARANA URBANO II PROGRAM

Operation No. 1405/OC-BR
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BRAZIL

PARANÁ URBANO II PROGRAM

(BR-0374)

LOAN PROPOSAL

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ABBREVIATIONS

AFP	Agência de Fomento do Paraná, S.A. [Paraná Development Agency]
AM(s)	association(s) of municipalities
BANESTADO	Banco do Estado do Paraná, S.A. [Paraná State Bank]
FDU	Fundo Estadual de Desenvolvimento Urbano [State Urban Development Fund]
FPM	Fundo de Participação dos Municípios [Municipal Revenue-sharing Fund]
GORs	General Operating Regulations
IAP	Instituto Ambiental do Paraná [Paraná Environmental Agency]
ICMS	imposto sobre operações relativas à circulação de mercadorias [value-added tax]
ICR	Relative Shortfall Index
IDB	Inter-American Development Bank
IOSP	Index of Supply of Public Services
LRF	Lei de Responsabilidade Fiscal [Fiscal Responsibility Act]
OC	Ordinary Capital
PEDU	Programa Estadual de Desenvolvimento Urbano [State Urban Development Program] (PEDU)
PGR	Programa de Gestão por Resultados [Results-based Management Program]
PPU-I	Programa Paraná Urbano I [Phase I of the Paraná Municipal Development Program]
PRAM	Programa de Ação Municipal [Municipal Action Program]
SAM	Project Monitoring System
SANEPAR	Companhia de Saneamento do Paraná [Paraná Sanitation Company]
SCA	Environmental Control System
SEDU	Secretaria Estadual de Desenvolvimento Urbano [Paraná State Department of Urban Development]
SFM	Municipal Funding System—Paraná Urbano



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Brazil

Tentative Lending Program

2002

Project Number	Project Name	IDB US\$ Millions	Status
BR0301	Northeast Microenterprise	30.0	APPROVED
BR0355	Santa Catarina Highways Stage IV	150.0	APPROVED
BR0323	Prodetur II Northeast Region	240.0	APPROVED
BR0313	Acre Sustainable Development	64.8	APPROVED
BR0357	Para Urban Desenvolpemente (para Urbe)	48.0	
BR0364	Diversity in University	5.0	
BR0374	Urban Parana	100.0	
BR0378	PROMOTION OF ETHICS AND DEFENSE OF PUBLIC PATRIMONY	3.0	
BR0351	Goiania Water and Sanitation	50.0	
BR0365	Modernization Comptroller Office	5.0	
*BR0367	Termoacu Co-Generation Power Project	25.0	
*BR0370	Campos Novos Hydroelectric Power Project	75.0	
BR0324	Ceara Sanitation II	120.0	
*BR0394	Sao Salvador	37.0	
*BR0395	Termonorte	56.0	
Total - A : 15 Projects		1,008.8	
*BR0377	Electropaulo Capital Expenditures	75.0	
BR0254	Florianopolis-Osorio Highway Moderniz.	300.0	
BR0302	Fortaleza Urban Transport	86.2	
*BR0368	Carioba II Thermoelectric Power Project	74.5	
Total - B : 4 Projects		535.7	
TOTAL 2002 : 19 Projects		1,544.5	

2003

Project Number	Project Name	IDB US\$ Millions	Status
BR0373	Promotion of Cultural Development	10.0	
BR0318	Tourism Development Program Prodetur Sul	200.0	
BR0372	São Paulo Fiscal Administration	15.0	
BR0297	National Food/Agricultural Research Syst	60.0	
BR0366	Increase Eletric Power Supply	600.0	
BR0356	Espirito Santo Highways	73.0	
BR0391	Downtown São Paulo Rehabilitation Procentro	100.4	
BR0358	Financing of Private Delivery of Soc.ser	200.0	
BR0375	Urban Transportation Curitiba2	40.0	
BR0376	Sustainable Development in Amapa	21.0	
BR0369	State Reform Sector Loan	500.0	
BR0371	Sao Paulo Line #5	175.5	
Total - A : 12 Projects		1,994.9	
BR0266	New Irrigation Model	90.0	

	Total - B : 2 Projects	90.0
	TOTAL - 2003 : 14 Projects	2,084.9
	Total Private Sector 2002 - 2003	342.5
	Total Regular Program 2002 - 2003	3,286.9
* Private Sector Project		



BRAZIL

IDB LOANS

APPROVED AS OF APRIL 30, 2002

	<i>US\$Thousand</i>	<i>Percent</i>
TOTAL APPROVED	24,002,295	
DISBURSED	18,068,289	75.3%
UNDISBURSED BALANCE	5,934,005	24.7%
CANCELLATIONS	1,359,959	5.7%
PRINCIPAL COLLECTED	6,101,853	25.4%
APPROVED BY FUND		
ORDINARY CAPITAL	22,314,374	93.0%
FUND FOR SPECIAL OPERATIONS	1,558,545	6.5%
OTHER FUNDS	129,376	0.5%
OUTSTANDING DEBT BALANCE	11,966,436	
ORDINARY CAPITAL	11,552,597	96.5%
FUND FOR SPECIAL OPERATIONS	413,316	3.5%
OTHER FUNDS	524	0.0%
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	955,282	4.0%
INDUSTRY, TOURISM, SCIENCE TECHNOLOGY	6,106,855	25.4%
ENERGY	2,301,141	9.6%
TRANSPORTATION AND COMMUNICATIONS	3,802,919	15.8%
EDUCATION	852,705	3.6%
HEALTH AND SANITATION	2,889,865	12.0%
ENVIRONMENT	591,178	2.5%
URBAN DEVELOPMENT	2,219,438	9.2%
SOCIAL INVESTMENT AND MICROENTERPRISE	2,861,640	11.9%
REFORM PUBLIC SECTOR MODERNIZATION	1,075,192	4.5%
EXPORT FINANCING	244,977	1.0%
PREINVESTMENT AND OTHER	101,103	0.4%

* Net of cancellations with monetary adjustments and export financing loan collections



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STATUS OF LOANS IN EXECUTION AS OF APRIL 30, 2002

(Amounts in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED	AMOUNT DISBURSED	% DISBURSED
Before 1996	13	2,601,100	2,313,047	88.93%
1996 - 1997	14	2,493,265	1,282,181	51.43%
1998 - 1999	15	2,805,000	1,213,314	43.26%
2000 - 2001	17	2,610,192	195,930	7.51%
2002	3	420,000	0	0.00%
TOTAL	62	\$10,929,557	\$5,004,472	45.79%

* Net of Cancellations . Excluding export financing loans.

PARANÁ URBANO II PROGRAM

(BR-0374)

EXECUTIVE SUMMARY

Borrower:	State of Paraná	
Guarantor:	Federative Republic of Brazil	
Executing agency:	Serviço Social Autônomo Paranaícidade [State of Paraná Municipal Development Agency]	
Amount and source:	IDB (OC):	US\$100.0 million
	Local:	<u>US\$ 66.7 million</u>
	Total:	US\$166.7 million
Terms and conditions:	Amortization period:	25 years
	Grace period:	4 years
	Disbursement period (max.):	4 years
	Disbursement period (min.):	3 years
	Interest rate:	variable
	Inspection and supervision:	1%
	Credit fee:	0.75%
	Currency:	Currency pool
Objectives:	<p>The program's objective is to help enhance the quality of life of residents of the state of Paraná by: (i) improving the municipal finance model; (ii) strengthening the institutional capacity of municipalities and associations of municipalities; (iii) establishing sustainable management and funding approaches for sectors with strong externalities and spillovers; (iv) improving the municipal investment priority-setting system with civil society participation; and (v) improving the quality and coverage of municipal basic and social services.</p>	
Description:	<p>The program will be structured to finance the following subprograms and components:</p> <p>1. Administration and supervision (US\$4 million)</p> <p>This funding will pay for general administration and support for the program's execution, including the hiring of an outside agency for annual program evaluations, technical audits of construction projects</p>	

and technical services provided by associations of municipalities, and audits of the program's finances and accounting.

2. Direct investment (US\$161.7 million)

a. Municipal development (US\$11 million)

This component consists of financing for the design and implementation of measures to continue developing the municipal sector, focusing on the municipal finance system, and to improve the efficiency of municipal governments.

- (i) **Strengthening of Paran  cidade:** (a) certification of Paran  cidade, by an internationally recognized rating agency, as a manager of third-party funds; (b) study of avenues for attracting private capital for municipal funding; (c) study on alternatives to keeping value-added tax (ICMS) transfers as municipal security for borrowings; (d) development of a borrower and project risk assessment model; (e) development of a model for estimating municipalities' fiscal potential; and (f) development and implementation of a municipal ranking system.
- (ii) **Strengthening of the Paran   State Auditing Agency to implement the Results-based Management Program associated with the Municipal Reporting System developed by that agency:** (a) computer hardware purchases; (b) software purchases; (c) systems development; and (d) training.
- (iii) **Institutional strengthening of municipalities, associations of municipalities, and civil society:** (a) implementation of the Results-based Management Program; (b) development of a system for management of municipalities' primary balances and borrowing capacity; (c) supplementing of urban mapping coverage; (d) training for municipal employees in municipal management, property roll updating, geoprocessing, results-based management, and the tax code; (e) strengthening of associations of municipalities; (f) technical studies on local government; and (g) four pilot projects for civil society participation in municipal investment priority-setting.

b. Modernization of management and funding in the sphere of public cultural goods (US\$22 million)

This component will fund the design and implementation of reforms of institutional and funding mechanisms for managing these sectors, and investments to make the reforms viable and expand services in these areas.

- (i) **Support for consolidation of management approaches:** (a) launch of the Paraná State Cultural Foundation (Paranácultura) and development of business plans for the Paraná Museum and Cultural Center Network; (b) launch of “Artes de Paraná” (A-PAR), a public-interest civil society organization to manage the new Paraná Art Gallery; and (c) monitoring of implementation of the State Cultural Policy, the impact of the reforms implemented, and recommendations for adjustments.
- (ii) **Remodeling, expansion, and outfitting of cultural infrastructure:** (a) remodeling, expansion, and supplementary outfitting of the Castello Branco building in the state civic center to house the Museum of Contemporary Art, the Paraná Art Gallery, Casa João Turim, and the Museum of Architecture and Urbanism; (b) rehabilitation, remodeling, expansion, and supplementary outfitting of São Francisco Palace to house the six Paraná Museum sites; and (c) expansion, remodeling, and supplementary outfitting of the Canal da Música building to house the Paraná Cultural Broadcasting System, which includes Educational Television and Radio.
- (iii) **Paraná cultural center network:** (a) rehabilitation and outfitting of a cinema/theater in each of the following cities: Guaíra, Andirá, União da Vitória, Rio Negro, Arapongas, Jacarezinho, Apucarana, Loanda, Londrina, Morretes, Castro, Paranavaí, Campo Mourão, and Ponta Grossa; and (b) support to municipalities for cultural center management and operations and equipment maintenance.
- (iv) **Design of sustainable urban heritage preservation systems:** (a) support for the municipalities of Antonina, Morretes, and Paranaguá to design comprehensive programs to rehabilitate their heritage areas, with the participation of all stakeholders and putting real property to sustainable uses; and (b) support for innovative initiatives to preserve buildings of significance for the historic heritage of Paraná, involving property owners, developers, and private philanthropy.

c. Municipal basic infrastructure investments (US\$128.7 million)

This component will fund rehabilitation, expansion, and construction projects in all sectors falling under municipal jurisdiction, such as: (i) urban streets and rural roads; (ii) autonomous water and sanitary

sewerage systems; (iii) storm drainage; (iv) social services such as education, health, child care, and community centers; (v) urban utilities such as integrated solid waste management and street lighting; (vi) urban facilities such as transit terminals, markets and slaughterhouses; (vii) environmental conservation and amelioration, flood and erosion control structures, parks and green spaces; (viii) local roads; and (ix) support for small and micro producers. This component also will fund sanitary sewerage systems, including sewer expansion or construction and efficiency improvements in sewage treatment plants in municipalities with populations under 100,000, in which the Paraná State Sanitation Company (SANEPAR) holds the concession.

**The Bank's
country and
sector strategy:**

During the period 2000-2003 the Bank's activities in Brazil are focusing on five main areas: (i) modernization of the State; (ii) competitiveness; (iii) poverty reduction; (iv) the environment; and (v) regional integration. In the area of modernization of the State, the Bank will deepen its support for administrative and fiscal modernization at the federal, state, and municipal levels. To improve competitiveness, one focus is to help boost investment in infrastructure and institute sound regulatory frameworks. The fight against poverty calls for implementation and deepening of social sector reforms and for urban and municipal development, with the goal of improving the efficiency, equity, and quality of services provided to citizens. Bank activities for the environment place special emphasis on urban sanitation, solid waste treatment and pollution abatement generally.

According to the Bank's subnational development strategy approved by the Board of Executive Directors in May 2001, the Bank will assist countries in implementing reforms and institution-strengthening activities needed to establish efficient, democratic subnational governments equipped to perform the functions of: (i) promoting economic development in their respective jurisdictions; (ii) delivering services to afford the population a good quality of life and achieve a more equitable societal and geographic distribution of the fruits of progress; and (iii) providing essential infrastructure for the welfare of the population and to spur economic growth. To this end, the strategy promotes improvements in intergovernmental relations, governance, local governments' institutional capacity, and strict discipline in borrowing.

The proposed program pursues both those strategies, since it will help improve the living conditions of the population by enhancing the efficiency, quality, and equity of municipal services in the state of Paraná, giving civil society a greater say in the resource allocation process, and promoting local economic development.

Environmental and social review:

The investments to be financed under the program will have positive environmental and social impacts, which will vary according to the sector in question. Generally, they will: (i) improve quality of life and health indicators of the population, through targeted social service projects and restoration of the state's historic and cultural heritage; and (ii) improve environmental conditions in the state by lessening the impact of solid waste and wastewater, eliminating environmental liabilities, implementing land-use plans, and strengthening associations of municipalities in the area of environmental protection. The environmental standards and protection measures will be included in the program's Operating Regulations by way of the Environmental Control System, which is integrated with the Project Monitoring System and will be strengthened for purposes of environmental protection and monitoring of the investments.

Benefits:

The program will improve the coverage and quality of services delivered by municipalities, primarily to low-income groups, through economically viable projects to rehabilitate and expand urban and social infrastructure.

Other more aggregated benefits of the program will come from bringing in private capital to finance municipal activities, better and more transparent allocation and use of municipal fiscal resources, heavier civil society involvement in municipal resource allocation, and greater efficiency in investments.

The program will improve the delivery of public goods and those with strong externalities through incentives to remedy these market deficiencies, primarily in the areas of rural roads, cultural goods, and restoration of the state's historic heritage.

Risks:

Despite the changes successfully implemented by the State of Paraná in recent years, there always is some risk of a reversal of course owing to their impact on political and economic interests. In particular, the new borrowing and transparent resource allocation system strengthened local communities and authorities in investment decision-making at the expense of "parliamentary initiatives", which are entirely discretionary. Moreover, the privatization of financing, which ensures that more funds and investments are available, has been strongly criticized for ignoring externalities and in some cases spillovers of the benefits of certain types of goods, such as public goods, that could result in an undersupply of the goods. Accordingly, the program includes a strategy and activities to offset the risk of any such reversal. Bringing the private sector into municipal finance will be a significant step forward in attracting private capital to the sector, which likewise will reduce the risk of any reversal of course.

With regard to the undersupply of public goods, the planned component for modernization of management and funding of public cultural goods is considered a reform of state activities precisely to address these issues.

Private partners' contributions to the operation and maintenance of cultural facilities may be insufficient to cover all the costs. In that scenario the state government will put in additional contributions to make up the shortfall and ensure that the facilities are properly operated and maintained. This commitment will be embodied in the standard operation and maintenance clause.

**Special
contractual
conditions:**

Conditions precedent to the first disbursement: (i) an addendum to the agreement between the borrower and the Paraná Development Agency (AFP) must be signed, for that agency to lend to eligible municipalities under the program (see paragraph 3.2); (ii) the Specific Operating Regulations for the program must be approved and in force (see paragraph 3.3); and (iii) models for the following instruments must be submitted: (a) "terms of participation" undertaking by municipalities joining the program; (b) Paranacidade/municipality agreement; (c) subloan contract between the State of Paraná and the Paraná Sanitation Company (SANEPAR), and AFP/municipality loan contract; (d) Paranacidade/association of municipalities technical cooperation and financing agreement; and (e) appendix to the Paranacidade/municipality agreement (see paragraph 3.13).

Conditions precedent to disbursement of funds for works projects: (i) AFP/municipality loan contract or State/SANEPAR subloan contract must be signed (see paragraph 3.28); (ii) utility companies must pledge to cooperate (see paragraph 3.29).

Specific conditions precedent to calls for bids: (i) signature of the municipality/Paranacidade "terms of participation" undertaking; (ii) signature of the SANEPAR/Paranacidade cooperation agreement; (iii) detailed designs for the works project, and (iv) setup permit from the state environmental agency and evidence of compliance with that agency's requirements (see paragraph 3.37).

Conditions precedent to the first disbursement for the subprogram for modernization of management and funding of public cultural goods: enactment of the law establishing the State Cultural System (see paragraph 2.6).

Conditions precedent to the first disbursement for procurement of goods or construction contracting for: (i) **Paraná Art Gallery:** (a) the museum's business plan must be submitted to the Bank for approval; (b) the civil society organization "Artes de Paraná"

(A-PAR) must be legally established and operational, and (c) the building design layout for the new Art Gallery must be adjusted (see paragraphs 2.7(a) and 4.9(ii)); (iii) **Paraná Museum or cinema/theaters**: the Paraná State Cultural Foundation (Paranácultura) must be legally established (see paragraph 2.7(b)), and (iii) **Canal da Música**: (a) the building out of which Canal da Música operates must be transferred to Educational Television and Radio which will be responsible for its operation and maintenance (see paragraph 2.7(c)); (b) designs for remodeling that building must be adjusted to meet the needs of the organizations it will house and to fit into the budget (see paragraph 4.9(iii)), and (c) equipment needed to provide support through the state Internet network must be added (see paragraph 4.9(i)).

Conditions during program execution: (i) within 12 months after the effective date of the loan contract, the Paraná State Development Agency (AFP) must have been brought under the Paraná State Department of Urban Development (SEDU) and, before the last disbursement under the loan contract, the approach selected to bring private funding into the SFM must be implemented (see paragraph 3.4); (ii) the Bank may recognize up to US\$15 million equivalent in expenditures incurred since 18 October 2001, as part of the local counterpart contribution (see paragraph 3.42); (iii) 90 days after the end of each fiscal year, the borrower must submit to the Bank a program evaluation report prepared by an outside agency (see paragraph 3.46); (iv) within nine months after the effective date of the loan contract, the borrower must commission the program evaluation, in accordance with Bank-approved terms of reference (see paragraph 3.46); (v) six months after the date of the last disbursement of the loan, the borrower must submit to the Bank an ex post evaluation report on the program's impact (see paragraph 3.49); and (vi) each works project's operating, administration, maintenance, and capital costs are to be recovered through revenues raised by the municipality, state or utility or service provider, obtained *inter alia* from taxes, rates, betterment levies, rent, or concession fees, according to the law. When a project's beneficiaries cannot be clearly identified, no discrimination would be justified, or the beneficiaries' socioeconomic situation so warrants, the municipality's or state's general revenues may be used for cost recovery. In such cases it must be demonstrated that the project will not create a primary deficit in the municipality's or state's finances.

Poverty-targeting and social sector classification:

This operation qualifies as a social equity enhancing project, as described in the indicative objectives for Bank activities set forth in the Report on the Eighth General Increase in Resources (document AB-1704). Furthermore, the operation qualifies as a poverty-targeted investment (PTI) (see paragraph 4.21). The borrower will not be using the 10 percentage points in additional financing.

**Exceptions to
Bank policy:**

None.

Procurement:

Bank procedures will be followed for the procurement of goods and awarding of construction and service contracts under the program. International competitive bidding will be mandatory for construction contracts worth US\$5 million or more, purchases of goods costing US\$350,000 or more, and services worth more than US\$200,000 (see paragraphs 3.33 and 3.34). The Bank will conduct an ex post review of documents and of tendering processes when the cost of a contract for construction work or goods is below those thresholds and when contracts with consulting firms or individual consultants are below US\$200,000 and US\$50,000, respectively. Price can be used as a criterion for consultant service selection, as stipulated in document GN-1679-3 (see paragraph 3.34).

I. FRAME OF REFERENCE

A. Changes in production patterns in Paraná, their impact on urbanization and the structure of municipal finance

1. Shifting production patterns and their impact on urbanization

1.1 According to the 2000 Census, the state of Paraná in southern Brazil has a population of 9.6 million, making it the sixth most heavily populated state in the country. Its gross domestic product (GDP) is the equivalent of 6.5% of national GDP, placing it fifth among the 27 states in the federation. It also ranks fifth for per capita GDP, at US\$6,400—approximately 12% higher than the national average.

1.2 Traditionally, the structure of production in the state was based exclusively on coffee farming. However, over the last two decades, as the coffee-growing frontier has reached its limit, new mechanized crops have been introduced, and—in the past eight years—heavy industry, such as the automotive industry, has been developed, the pattern has undergone major changes. These have been reflected in a reduction in the primary sector share of state GDP, an increase in the tertiary sector, and more diversification of industry toward export products. Overall, industrial exports and services account for close to 80% of state GDP.

1.3 One result of this shift has been a considerable increase in the state's urban population. According to the data in Table I-1, a very large share of the state population (81%) lives in towns and cities. Between 1996 and 2000 the urban population grew at an annual rate of 2.6%, while the rural population declined at the significant rate of -2.2%. As a result, 56% of the total population and 65% of urban residents are concentrated in 30 of the state's 399 municipalities.

Table I-1

Year	Rural population	Urban population	Total population
1991	2,250,760	6,197,953	8,448,713
1996	1,991,814	7,011,990	9,003,804
2000	1,776,790	7,781,664	9,558,454
1991 - 1996	-258,946	814,037	555,091
1996 - 2000	-215,024	769,674	554,650
1991 - 2000	-473,970	1,583,711	1,109,741
Annual % growth	-2.2	2.6	1.4

Source: 2000 Population Census – Brazilian Bureau of Surveys and Statistics (IBGE)

1.4 This phenomenon is attributable to the growing demand for labor in the secondary and tertiary sectors in medium-sized and large cities, and to the better infrastructure and more complex, technologically sophisticated services available and the presence of artistic, cultural and recreational activities in cities that are major or minor regional hubs.

1.5 The growth of industry and services in these cities has not been able to absorb the entire population that has migrated from rural areas, since the new investments are capital- and skilled labor-intensive. Consequently, migratory flows to medium-sized and large cities continue to put pressure on existing urban infrastructure and essential social services.

2. The structure of municipal financing

- 1.6 The municipalities, which have a great deal of management autonomy, are being called on to address these pressures, since they are required to provide services to their entire population, including rural areas. Apart from urban utilities and facilities they are in charge of basic education, health promotion and preventive and primary health care, social services such as day care for children and centers for the elderly, and local road construction and maintenance.
- 1.7 Municipalities' revenue sources to fund these services, including services that are under the pressures referred to above, are taxes and other local rates and levies, transfers, and borrowings.
- 1.8 Revenue vehicles on the taxation side, where municipalities are fully empowered to set rates, are the property tax, service taxes, asset transfer tax, user fees, betterment levies, and utility rates.

- 1.9 Municipalities likewise receive funds from the federal and state governments through two kinds of transfers—systematic (constitutionally mandated), apportioned as described in Table I-2, and non-systematic (discretionary). Systematic federal government transfers consist mainly of: (i) the Municipal Revenue-sharing Fund (FPM) and (ii) 50% of property taxes on property located in the rural areas of municipalities. State government transfer monies come from 25% of the state value-added tax (ICMS) and 50% of the vehicle tax. Both federal and state nonsystematic or voluntary transfers are earmarked primarily for the health and education sectors.

Table I-2
Systematic transfers to municipalities

FPM: State capitals (in Paraná, Curitiba) receive 10% of the FPM, allocated according to population size and inversely proportional to state per capita income. All other municipalities in the country share 86.4% of the **FPM**, based exclusively on their population size. Municipalities that are not state capitals but have populations over 156,216 share the remaining 3.6%.

ICMS: According to the Constitution, 75% of ICMS proceeds are to be distributed according to origin of the tax and the remaining 25% as prescribed in state law. In the case of Paraná, the formula favors rural municipalities.

- 1.10 Municipalities also borrow on the financial and capital markets. However, under the *Real Plan* launched in 1994, as a fiscal policy measure, steps were taken to rein in mounting public sector debt. To that end, in 1995, the federal Senate established caps on public sector debt. The Senate subsequently decided that further adjustments were in order and enacted Resolution 78/98, setting new ceilings on debt flows and debt stock, as described in Table I-3, thereby further restricting subnational government borrowing.

Table I-3

Annual borrowing capacity: 18% of net revenues less disbursements for current operations. **Primary balance:** total revenues less borrowings less total expenditures plus debt service, greater than zero. **Debt stock:** ratio of net annual revenues to debt stock, 1.2 or higher (2002).

B. State policy on municipal development

- 1.11 To promote municipal development, in the 1980s the State of Paraná established a State Urban Development Fund (FDU) to provide financing to municipalities through loans to expand the coverage of urban infrastructure and services. To that end, in 1985 the state secured US\$150 million in funding from the World Bank to carry out the Municipal Action Program (PRAM), under which the state financed basic infrastructure works in 229 municipalities of up to 50,000 inhabitants. A subsequent phase of this program with the same objective, called the State Urban Development Program (PEDU), for US\$200 million for all municipalities was launched in 1989 and completed in 1996.
- 1.12 Despite the various sources of financing available, including the two credit programs for urban development (PRAM and PEDU), municipal services were becoming increasingly insufficient and municipalities' investment and financing capacity could not keep pace.
- 1.13 In order to understand the problem and design a strategy to address it, in 1995 the then-new state administration conducted two studies, examining: (i) the impact of constitutionally mandated federal and state transfers on local finances and (ii) the effectiveness of the PRAM and PEDU programs in resolving municipal problems in the state.
- 1.14 The first study showed that the automatic transfer system afforded no incentive for local resource mobilization (tax effort), estimating that only about 25% of municipalities' fiscal potential was being tapped. In addition to limiting municipalities' political autonomy, efficient local resource allocation, and responsiveness to the demand for services, that lack of incentives also neutralized the transfers' impact on vertical imbalances. The study also revealed that when the nonsystematic transfers did not fund the entire expenditure incurred by municipalities, they required only a small counterpart contribution, thereby also contributing to fiscal laxity on municipalities' part.
- 1.15 The second study found that in order to be more effective, a program should: (i) be municipal in scope and not just urban; (ii) create incentives to mobilize more local resources, introducing cost recovery of the services provided and setting institutional and fiscal targets with municipalities; (iii) have a component to support small and micro producers; (iv) finance child care facilities to enable mothers to work; and (v) attract private-sector sources of municipal finance in order to increase the funding available and improve fiscal accountability.
- 1.16 Based on the above-mentioned studies, after preparing plans for basic service delivery the state government developed a strategy. Its main pillars were to promote changes in state contributions to municipal financing, stimulate mobilization of local tax, levy and rate revenues, provide institution-strengthening support to

municipalities, and stimulate growth in productive sectors. Under the strategy, with support from a US\$249 million Bank loan approved in 1996 (917/OC-BR), the State of Paraná implemented the first phase of a municipal development program called “Paraná Urbano I” (PPU-I) totaling US\$426 million. The project was completed in 2001, as scheduled in the contract.

- 1.17 The objective of PPU-I was to help municipalities¹ improve the quality of life of their population and support the state government in its municipal strategy for the provision of services and job creation. To achieve this objective, the program supported: (i) development and strengthening of municipalities and associations of municipalities on the institutional, financial, and technical side, in order to improve their efficiency and service coverage; (ii) improved fiscal efficiency on the part of municipalities, by promoting cost recovery, streamlining spending, and producing studies on a revamping of the transfers system; (iii) establishing mechanisms to make the municipal project financing system transparent by reducing discretionality; and (iv) rehabilitation, expansion, and construction of infrastructure falling under the purview of municipalities and under state purview when the benefits would accrue to municipalities.

C. Achievements and lessons learned from Paraná Urbano I

- 1.18 Based on a review of the first phase of the Paraná municipal development program, which included evaluation of a sample of 39 projects carried out by municipalities, the technical assistance provided, and implementation procedures followed, the program achievements were identified as were the lessons learned, which were taken into account in designing the operation proposed here.

1. Achievements

a. Institutional organization of the sector

- 1.19 With support from phase one of the program, as a first step in revamping the municipal financing structure, an innovative decentralized system was implemented for the program that involved the following institutions, in addition to the Paraná State Department of Urban Development (SEDU):
- a. 18 associations of municipalities to help the municipalities identify and prepare investment projects, inspect, supervise, and measure construction, and approve projects costing less than US\$200,000. Close to 2,400 projects such projects were reviewed and approved.
 - b. A private, not-for-profit institution, Paranácidade, reporting to the SEDU, headed by the Secretary of the SEDU, with institutional and financial autonomy,

¹ Curitiba, the state capital and largest city, was not eligible for the PPU-I because of its size.

established specifically to manage the FDU and the PPU-I program and to provide technical assistance to municipalities.

- 1.20 To perform its duties, Paranácidade developed and implemented an online project monitoring system and a fiscal database on the state's 399 municipalities. In addition, to assist the municipalities, it developed a series of nonfinancial products such as the Results-based Management Program (PGR) implemented in 100 municipalities, methodologies, technical papers on municipal issues, and financial and project management software.
- 1.21 Paranácidade's activities have led it to be considered an innovative management model by other multilateral lending agencies such as the World Bank, by various countries in Latin America, Asia, and Europe, and by other Brazilian states, which have signed cooperation agreements and sent technical missions for training and exchanges of experience.

b. Municipal finance

- 1.22 With a view to bringing private capital into municipal financing, the PPU-I program funded feasibility studies on the use of financial instruments such as municipal bonds and securitization. However, the Russian crisis in 1998 and the effect of the *precatório* situation on investor confidence² stalled the move to change a predominantly public financing system to one featuring private-sector participation.
- 1.23 As an intermediary step, as in the case of previous programs financed by the World Bank, phase one of the Municipal Development Program continued to use Banco do Estado do Paraná, S.A. (BANESTADO) as its financial agent. Upon authorization by Paranácidade, BANESTADO began lending to municipalities with repayment periods of up to 10 years, grace periods of up to 12 months, and a fixed annual lending rate of 8% on outstanding balances adjusted for inflation. To disburse its loans, BANESTADO also had to receive authorization from Paranácidade.
- 1.24 Under this system, phase one of the program financed close to 3,300 investment projects and 700 institution-strengthening projects in 390 municipalities of the 398 eligible under the program. The institution-strengthening projects funded mapping, updating of municipal tax codes, and multipurpose land registries in almost all the municipalities, among other activities. Under the works component, close to 2,400 urban utility projects, 700 social service projects, and 200 projects to support small and micro producers were funded.

² Refers to the raising of funds through government security issues to cover contingent indemnity payments to workers. However, because some municipalities overestimated such potential outlays in order to use the balance for other expenditures, the federal Senate eventually suspended authorization for such fund-raising vehicles and potential investors became wary.

- 1.25 Table I-4 breaks down the PPU-I resources by category of expenditure and project type. It shows that municipal demand focused on works and equipment for basic urban services such as street lighting, streets, integrated solid waste management, and urban environmental control. Targeted social services, with close to 9%, and the small and micro producer support component, with around 2.5%, followed in order of importance.

Table I-4
Breakdown of PPU-I funding by item of expenditure

Category	Number of projects	US\$ million	%
Administration	N/A	17.5	4.1
Institutional development	712	19.1	4.5
Tax management (codes, property rolls, registries)	63		
Urban planning management (land-use plan)	43		
Preinvestment	65		
Mapping, hardware and software	520		
Other	6		
Basic urban services	2,367	337.9	79.3
Street lighting	80	13.5	3.2
Urban street system	950	160.8	37.7
• <i>Paving</i>	930		
• <i>Bicycle paths</i>	6		
• <i>Masonry works and signage</i>	14		
Transit infrastructure (terminals)	37	12.1	2.7
Road maintenance equipment	745	59.1	13.9
Urban environmental control	57	6.6	1.6
Solid waste management	123	4.6	1.1
Sanitation	137	81.2	19.1
Targeted social services	720	39.4	9.2
Social services	175	11.5	2.7
• <i>Child care centers</i>	111		
• <i>Centers for support for seasonal workers</i>	10		
• <i>Community centers and funeral homes</i>	38		
• <i>School transportation</i>	16		
Construction and equipment for culture and sports	265	20.9	4.9
• <i>Squares</i>	146		
• <i>Cultural centers</i>	18		
• <i>Gymnasiums and sports centers</i>	50		
• <i>Other</i>	51		
Health care infrastructure and equipment	280	7.0	1.6
• <i>Simple (basic clinic)</i>	62		
• <i>Moderately complex</i>	22		
• <i>Ambulances and other transportation equipment</i>	196		
Support for small and micro producers	147	10.2	2.4
Manufacturing and commerce	127	9.9	2.3
Farming	16	0.3	0.1
Inspection and supervision	N/A	2.0	0.5
Grand total	3,945	426.1	100.0

- 1.26 The apportionment of funds by cluster of municipalities³ for works and technical assistance is shown in Table I-5. As the figures illustrate, the less developed

³ Following a multivariable analysis, homogeneous municipalities were grouped into clusters according to social and economic variables. Curitiba is the only cluster 1 municipality.

municipalities benefited most from the program, receiving 35% of the funds and US\$50 per beneficiary, compared with the program average of US\$45.6 called for in the original design.

- 1.27 A survey of 200 municipalities conducted in July 2000 showed that over 80% of residents fully approved of the works and improvements carried out in their cities under phase one of the Paraná Urbano program.

- 1.28 As of December 2001 there were no arrears in the loan portfolio of around US\$350 million. This performance record is attributable largely to the institutional financial analysis done by Paranácidade, the technical assistance provided, and the program's cost recovery provisions, and the debt ceilings prescribed by the federal Senate and loan security arrangements involving withholdings of constitutionally mandated state transfers.

Table I-5
Allocation of funds by clusters of municipalities

Cluster of municipalities	Works and equipment (US\$ million)	Number of beneficiaries	Technical assistance (US\$ million)
1	-	-	-
2	67.6	1,512,211	2.0
3	54.4	1,287,443	0.4
4	42.9	1,096,534	1.0
5	65.6	1,499,053	1.2
6	156.9	2,477,156	1.2
TOTAL	387.4	7,872,397	5.8

- 1.29 However, with the enactment in 2000 of Law 101, the Fiscal Responsibility Act (LRF), which prohibited lending between Brazilian government agencies and thus prevented states from lending to municipalities via such funds as the FDU, financing to municipalities was halted. Under the LRF, municipalities may only borrow from public or private financial institutions authorized and supervised by the Central Bank. In states that had their own banks, the funds were capitalized in those banks. In states such as Paraná that had privatized their banks, the law allowed them to establish a development agency⁴ in which the funds would be capitalized.⁵ In order to continue funding municipalities, the SEDU signed an agreement with the Paraná Development Agency (AFP) which is attached to the Ministry of Finance. The agreement establishes the authority and responsibilities of Paranácidade in the new institutional framework for municipal financing and the system for capitalizing the AFP with approximately US\$350 million in FDU resources. The agreement states that Paranácidade will continue to perform the same functions it discharged under the previous system with BANESTADO, and that funds provided to the municipalities will be periodically capitalized according to a loan approval schedule.

⁴ Institutions of this kind may operate only in the state that controls them and are funded with their capital, state budget funds, and funding from national and international development agencies.

⁵ The Paraná Development Agency (AFP) is to be capitalized upon approval of each credit operation, which will lead to eventual dismantling of the FDU upon completion of the program proposed here.

c. Mobilizing local resources

1.30 The requirements under phase one of the Paraná Urbano program with respect to cost recovery for investments and operating and maintenance costs, along with the goals for launching and collecting all municipal levies and institutional strengthening, enabled municipalities to increase their fiscal effort and reduce their reliance on transfers.

1.31 Table I-6 shows selected fiscal dependence indicators for clusters of municipalities in the state of Paraná in 1996 (the first year of phase one of the Municipal Development Program) and 1999 (the last year with audited municipal financial statements). Fiscal reliance on transfers was heavier in the less developed municipalities, where constitutionally mandated federal and state transfers represented 85% of current revenues. However, the 1999 figures show that dependence decreased by close to 16 percentage points, even though federal transfers rose 67.3% during that period, suggesting that the incentives to develop local sources of funding (fiscal effort) had the anticipated impact.

Table I-6
Fiscal dependence indicators in 1996 and 1999

Cluster of municipalities	Taxes + other levies/ Current revenues (%)		Taxes / Current revenue (%)		Current transfers/Current revenue (%)	
	1996	1999	1996	1999	1996	1999
1	58	60	43	41	42	40
2	50	52	22	20	50	48
3	28	30	15	14	72	70
4	30	34	13	12	70	66
5	25	30	8	8	75	70
6	10	15	3	3	90	85
Average	24	40	18	28	76	60

1.32 Table I-7 presents per capita changes in the chief municipal revenue sources from 1996 to 1999. Municipal taxes, betterment levies, and rates increased the most during the period. Taxes rose more in the less developed municipalities. The financing structure shifted to one more dependent on rates and betterment levies,

Table I-7
Per capita municipal revenues (R\$)

Revenue type	Year	Cluster of municipalities						TOTAL
		1	2	3	4	5	6	
Taxes	1996	156.0	63.4	42.5	28.3	20.6	9.5	50.3
	1999	190.0	57.1	48.3	34.1	27.2	12.0	58.5
	Increase	21.3%	(10.0%)	13.0%	20.4%	31.8%	26.9%	16%
Rates	1996	26.1	33.7	18.2	15.9	9.8	4.5	16.6
	1999	35.9	50.0		22.2	13.9	6.5	23.5
	Increase	37.8%	48.4%	26.1%	39.1%	41.6%	45.5%	41.6%
Betterment levies	1996	0.13	2.5	2.2	1.00	0.85	0.47	1.1
	1999	0.31	5.2	2.6	1.6	0.85	0.72	1.7
	Increase	20.6%	17.3%	29.4%	19.8%	32.7%	40.1%	29.9%
Transfers	1996	154.0	146.4	184.6	159.2	186.9	253.6	189.7
	1999	185.7	171.7	238.9	190.8	248.0	355.3	246.4
	Increase	20.6%	17.3%	29.4%	19.8%	32.7%	40.1%	29.9%
Total without transfers	1996	67.9	99.6	62.8	45.2	31.3	14.4	67.9
	1999	83.7	112.4	73.7	57.9	42.0	19.2	83.8
	Increase	23.3%	12.8%	17.3%	28%	34.1%	33.5%	23.4%

with the “fiscal illusion” declining. This performance helped the municipalities reduce their fiscal dependence on constitutionally mandated transfers. The shift was due mainly to: (i) the requirement under phase one of the program to recover investment costs through privatization arrangements such as concessions with charges, fees, rates and betterment levies, as a criterion for eligibility to continue receiving funding under the PPU-I program; (ii) institutional strengthening of the municipalities with established fiscal targets; and (iii) a borrowing mechanism that led the municipalities to seek to increase their borrowing capacity so that they could make the investments demanded by their communities.

d. Debt

- 1.33 Discounting the effect of the rise in federal transfers on borrowing capacity, under phase one of the program, the municipal debt ceiling rose from US\$20 million in 1996 to around US\$80 million in 1999. A total of

Table I-8
FDU-sourced investment funding (R\$ millions)

Cluster	1996				1999			
	Invest.	Loans	FDU	FDU/ loans (%)	Invest.	Loans	FDU	FDU/ loans (%)
1	144.7	52.5	-	-	79.2	26.9	-	-
2	70.5	5.2	3.3	63.5	60.0	30.6	30.6	100.0
3	55.0	5.2	2.4	46.2	79.8	27.8	26.8	96.4
4	34.6	4.4	2.7	61.4	33.5	10.1	10.1	100.0
5	63.5	9.6	6.1	63.5	80.7	16.6	15.8	95.2
6	102.1	14.7	10.3	70.1	129.5	29.7	29.7	100.0
Total	470.4	91.5	24.8	27.1	462.8	141.7	113.0	79.7

US\$70 million of that sum was municipal borrowings, which accounted for a mere 3.7% of municipalities’ total funding that year, 80% of it financed from the FDU—except for Curitiba—and the balance by Caixa Econômica Federal and the National Bank for Economic and Social Development, both owned by the federal government.

e. Streamlining spending

- 1.34 Municipal funds in the state of Paraná are mainly used to finance current expenditures. Of these, less than 50% go for payrolls and, as shown in Table I-9, all are below the Fiscal Responsibility Act 60% cap. The ratio of current expenditures to total expenditures increased over the period under review as a result of the investments financed by the program and investment cost recovery, which freed up resources for operation and maintenance.

Table I-9
Spending indicators, 1999

Cluster of municipalities	Payroll/Net current revenue (%)		Current expenditure/ Total expenditure (%)		Capital spending/ Total expenditure (%)		Capital transfers/ Capital spending (%)	
	1996	1999	1996	1999	1996	1999	1996	1999
1	46.1	41.0	76.4	85.2	22.8	11.1	11.1	2.2
2	43.0	40.5	80.1	83.7	14.8	11.2	7.1	8.7
3	45.0	46.3	78.6	80.0	18.3	17.1	41.0	6.7
4	53.1	51.3	83.4	86.3	13.3	10.7	36.8	10.9
5	46.7	47.2	82.0	81.4	15.2	14.8	27.5	27.6
6	45.8	46.0	83.7	84.8	13.5	12.0	28.8	23.2

- 1.35 In addition, thanks to the increase in locally raised own resources and greater borrowing capacity resulting from improvements in fiscal accountability introduced in phase one of the Paraná Urbano program, the municipalities needed fewer transfer monies for capital projects.

2. Lessons learned from phase one of the Paraná Municipal Development Program

- 1.36 The main lessons learned from the ex post evaluation and the project completion report concern the degree of strengthening required in the next operation for Paranácidade itself, the municipalities and associations of municipalities, and project monitoring and evaluation procedures.

a. Institutional organization of the sector

- 1.37 A major achievement of phase one of the program has been to create institutions to further decentralize decision-making and tasks in line with the assignment of responsibilities. However, although the associations of municipalities have been effective in resolving larger scale problems, in the case of project preparation and bidding procedures for construction contracts, the other strengthening functions that needed to be developed were left to the side. Developing these functions, which are more closely associated with project execution and exploring new investment opportunities or vehicles, will ensure the medium- and long-range sustainability of those institutions.

b. Problems in monitoring and efficiency and performance indicators

- 1.38 Perhaps the most crucial responsibilities that Paranácidade successfully performed during the first phase of the program were to identify eligible projects and borrowers and develop simple methods for

Table I-10
Lessons learned from project ex post evaluations

The project review, monitoring and supervision system needs a subroutine to update cost-efficiency parameters so that they reflect changes in the premised financial and economic conditions.

Certain standard project designs used by Paranácidade need to be reviewed and adjusted.

Efficient systems to verify policies and commitments for operation and maintenance are needed, along with an enforcement system with sanctions and incentives.

evaluation, monitoring and supervision of over 1,000 activities each year that ended up in some form of procurement. However, because it was taking care of its huge client base it did not attend to the development of instruments needed to: (i) manage its portfolio from a development objectives perspective; (ii) devise more efficient methods of allocating resources to meet highly dispersed demand; and (iii) measure the effectiveness of investments and actual benefits yielded by way of a performance-based monitoring system.

c. Priority-setting for investments and strategic action by the state

- 1.39 One lesson learned by default was drawn from the eligible sectors from which there was no effective demand during the first phase of the program, notably rural roads and investments for cultural services. Although these sectors had been identified as priorities according to the municipalities' mandates, they were not given priority by the local communities that assume the costs or receive direct benefits and negative externalities from them. This situation shows that the state must participate in identifying areas and models for intervention in sectors with strong externalities and spillovers to remedy market failings.

D. Challenges for phase two of the program

- 1.40 The achievements of Paraná Urbano I notwithstanding, the State of Paraná still has challenges to meet, as described below.

1. Institutional organization of the sector

- 1.41 One of the expected benefits of decentralization is improved service management through better performance by local governments, greater community participation in decision-making, and government accountability for the quality and coverage of local services. Although great progress has been made in this direction, some obstacles and tasks remain, such as: institutional weaknesses in the less developed municipalities; out-of-date land registries and property rolls in close to 25% of municipalities; implementation of the Results-based Management Program in all municipalities; implementation of integrated financial management systems; and staff training in implementation of the activities and operation of the required financial systems.
- 1.42 With regard to increasing community involvement in decision-making on local investments, the state plans to introduce a system of community participation with fiscal accountability. This means that the population, through its representative organizations, will participate in the capital budgeting process with full knowledge of the investments' benefits and financing costs and of cost recovery levels.
- 1.43 Furthermore, although the associations of municipalities have been crucial in decentralizing execution of phase one of the program, they have become reliant on the funds transferred under the program for service fees, sidelining other primary

functions such as implementing intermunicipal projects to achieve economies of scale, preparing regional development plans, and strengthening municipalities' negotiating capacity with the federal and state governments and with the private sector. Strengthening these associations, which is essential for the institutional model, is one of the challenges awaiting the State of Paraná.

2. Municipal finance

- 1.44 With state financing for municipalities having been halted by the Fiscal Responsibility Act that prohibits financing between government agencies, given the precarious alternative of creating a development agency, and the growing need for resources to finance the workings of municipalities, the state has had to rethink the current municipal funding system. In executing the proposed new phase of the program, the state faces the challenge of devising a permanent, sustainable system that can raise enough revenue to meet municipal demands.
- 1.45 With that in mind, the state decided that the new system needs to mobilize private resources and will use the Paraná Development Agency (AFP) as the vehicle to attract and place resources for municipalities. As a first step in this transformation, the AFP will be placed under the State Department of Urban Development (SEDU). Subsequently, an approach will be devised to attract private capital.

3. Management and financing of public goods

- 1.46 Although the state assigned high priority to public goods, whose benefits transcend the borders of any one municipality or have strong externalities, and those goods were eligible under phase one of the program, the desired investment levels were not achieved, leading to an undersupply of such goods. This situation especially affects services that create, disseminate and preserve cultural goods, since in other sectors such as health and education significant progress has been made in coverage and quality. In order to remedy this situation, the institutional and legal framework necessary to modernize management of state cultural services will have to be established, promoting participation by all societal stakeholders in their supply and financing.

E. The Bank's strategy

- 1.47 The strategy for Bank action in Brazil for the period from 2000 to 2003 focuses on five main areas: (i) modernization of the State; (ii) competitiveness; (iii) poverty reduction; (iv) the environment; and (v) regional integration. In the area of modernization of the State, the Bank will deepen its support for administrative and fiscal modernization at the federal, state and municipal levels. Efforts to promote competitiveness will seek to boost investment in infrastructure and establish sound regulatory frameworks. The fight against poverty calls for implementing and deepening reforms in the social sectors and urban and municipal development, to

improve the efficiency, equity, and quality of services provided to the public. Bank action for the environment places special emphasis on urban sanitation, solid waste treatment, and pollution abatement generally.

- 1.48 According to the Bank's subnational development strategy approved by the Board of Executive Directors in May 2001, the Bank will support countries in implementing reforms and in the institutional strengthening needed to establish efficient, democratic subnational governments equipped to perform the following functions: (i) foster economic development in their jurisdictions; (ii) deliver services needed to afford a good quality of life to the population and make for a more equitable social and geographic distribution of the fruits of progress; and (iii) provide essential infrastructure for the welfare of the population and to spur economic growth. To this end, the strategy promotes improvements in intergovernmental relations, governance, the institutional capacity of local governments, and strict discipline in borrowing.
- 1.49 The proposed program pursues both those strategies since it will help improve people's quality of life by enhancing the efficiency, quality, and equity of services delivered by municipalities in the state of Paraná, give civil society a greater say in the resource allocation process with fiscal accountability, spur local economic development, and help improve municipalities' fiscal capacity.

F. Bank experience

- 1.50 The Bank has extensive experience in the design of this type of operation. Lessons learned from the following operations were taken into account for the proposed program: phases one, two and three of the Municipal Development Program in Uruguay, phase one of the Paraná Municipal Development Program (917/OC-BR), the Historic and Cultural Heritage Preservation Program (1200/OC-BR), Large Urban Areas in the Interior of Argentina (1068/OC-AR), Local Development and Fiscal Accountability (1075/SF-BO), and Program to Strengthen Mexican States and Municipalities (LO-1213/OC-ME).
- 1.51 These operations showed that: (i) resources are allocated efficiently when the community has information on cost recovery systems (preference revealing mechanisms) to participate in decision-making on spending; (ii) investments must be one of the incentives for institutional adjustments; (iii) adjustments are more efficient when goals are agreed upon with the municipalities, with institutional projects that are tailor-made rather than prepared according to rigid formulas under the program; (iv) programs for municipalities should have adequate, transparent, easy-to-understand systems, such as simple formulas for the transfer of funds that use easily forecastable indicators (per capita revenue intake, service coverage and quality, and so on); and (v) projects with a strong public good and spillover component require incentives such as transfers to reach the optimal level of supply,

in such cases as cultural projects, rehabilitation of urban heritage sites, or local roads.

- 1.52 In addition, preparation of the cultural heritage program in Brazil showed that cultural and historic heritage projects need to be financially feasible and sustainable in and of themselves and that there is great income elasticity in the willingness to pay, so access mechanisms for segments of the population that have little ability to pay can be established (subsidies).

G. Value added of Bank participation in the program

- 1.53 The main added value of the Bank's participation in this second phase of the program is to help the state revamp the municipal financing system, bringing in private-sector participation, in order to ease the transition to a private municipal funding system. The Bank will support the development of an institutional framework in which funds for municipal finance—the FDU and the proposed program—will be unified in a Funding System for Activities of Municipalities in the State of Paraná (“Paraná Urbano II”), under the Paraná State Department of Urban Development (SEDU), that will be governed by regulations agreed upon with the Bank.

II. THE PROGRAM

A. Objectives

- 2.1 The program's objective is to help enhance the quality of life of residents of the state of Paraná by: (i) improving the municipal finance model; (ii) strengthening the institutional capacity of municipalities and associations of municipalities; (iii) implementing sustainable management and funding approaches for sectors with strong externalities and spillovers; (iv) improving the municipal investment priority-setting process, with civil society participation; and (v) improving the quality and coverage of urban basic and social services.

B. Description

- 2.2 The program will be structured to finance the following subprograms and components:

1. Administration and supervision (US\$4 million)

- 2.3 This funding will pay for general administration and support for the program's execution, including the hiring of an outside agency for annual program evaluations, technical audits of construction projects, technical services provided by associations of municipalities, and audits of the program's finances and accounting.

2. Direct investment (US\$161.7 million)

a. Municipal development (US\$11 million)

- 2.4 This consists of financing for the design and implementation of measures to continue developing the municipal sector, focusing on the municipal funding system and measures to improve the efficiency of municipal government service delivery.

- a. **Strengthening of Paranácidade:** (a) certification of Paranácidade, by an internationally recognized rating agency, as a manager of third-party funds; (b) a study of avenues for attracting private capital for municipal financing; (c) a study on alternatives to keeping value-added (ICMS) tax transfers as municipal security for borrowings; (d) development of a borrower and project risk assessment model; (e) development of a model to estimate municipalities' fiscal potential; and (f) development and implementation of a municipal ranking system relating to coverage, quality and cost of municipal services.

- b. **Strengthening of the Paraná State Auditing Agency** to implement the Results-based Management Program in all Paraná municipalities, associated

with the Municipal Reporting System developed by that agency: (a) computer hardware purchases; (b) software purchases; (c) systems development, and (d) training.

- c. **Institutional strengthening of municipalities, associations of municipalities, and civil society:** (a) implementation of the Results-based Management Program; (b) development of a system for managing municipalities' primary balances (nonfinancial revenue less nonfinancial outlays) and borrowing capacity; (c) supplementing of urban mapping coverage; (d) training for municipal employees in property roll updating, geoprocessing, the Results-based Management Program, and the tax code; (e) strengthening of associations of municipalities through studies to define their roles and funding sources, courses on management of multi-municipal consortia, definition of staff complements, etc.; (f) technical studies on local government; and (g) four pilot projects for civil society participation in municipal investment priority-setting.

b. Modernization of management and funding of the public cultural goods sphere (US\$22 million)

- 2.5 This component will fund the design and implementation of reforms to institutional and financial arrangements for managing these sectors, and investments to make the reforms viable and expand services in these areas.

- a. **Support for consolidation of management mechanisms:** (a) launching of the Paraná State Cultural Foundation (Paranácultura) and development of business plans for the Paraná Museum and Cultural Center Network; (b) launching of "Artes de Paraná" (A-PAR), a public-interest association to manage the new Paraná Art Gallery, and development of its business plan; and (c) monitoring of implementation of the State Cultural Policy, the impact of reforms introduced, and recommendations for adjustments.
- b. **Remodeling, expansion, and outfitting of cultural infrastructure:** (a) remodeling, expansion, and supplementary outfitting of the Castello Branco building in the state civic center to house the Museum of Contemporary Art, the Paraná Art Gallery, Casa João Turim, and the Museum of Architecture and Urbanism; (b) rehabilitation, remodeling, expansion, and supplementary outfitting of the São Francisco Palace to house the six Paraná Museum sites; and (c) expansion, remodeling, and supplementary outfitting of the Canal da Música building to house the Paraná Cultural Broadcasting System, which includes Educational Television and Radio.
- c. **Paraná cultural center network:** (a) rehabilitation and outfitting of 14 existing cinemas in the cities of Guaíra, Andirá, União da Vitória, Rio Negro, Arapongas, Jacarezinho, Apucarana, Loanda, Londrina, Morretes, Castro, Paranavaí, Campo

Mourão, and Ponta Grossa; and (b) support to municipalities to arrange the operation and maintenance of these facilities.

- d. **Design of sustainable urban heritage preservation systems:** (a) assistance to the municipalities of Antonina, Morretes, and Paranaguá to design comprehensive programs for rehabilitation of their heritage sites, under state protection, with input from all societal stakeholders and putting real property to sustainable uses in light of societal or market demands; and (b) support for innovative initiatives to preserve buildings of significance for the historic heritage of Paraná that are protected by the state or municipality, involving property owners, developers, and private philanthropy.
- 2.6 A condition for this component to become eligible for program funds will be enactment of the law establishing the state's cultural policy and system.
- 2.7 Other conditions precedent to disbursement of the program funds will be stipulated for: (a) **the Paraná Art Gallery:** submittal of this museum's business plan for Bank approval and evidence that the civil society organization "Artes de Paraná" (A-PAR) has been legally established and has begun operating; (b) **the Paraná Museum or the cinemas:** legal establishment and launch of the Paraná State Cultural Foundation (Paranácultura); and (c) **the Paraná Cultural Broadcasting System:** transfer of the building housing Canal da Música to Educational TV and Radio, which will be responsible for its operation and maintenance.

c. Municipal basic infrastructure investments (US\$128.7 million)

- 2.8 This component will finance rehabilitation, expansion, and construction projects in all sectors falling under municipal jurisdiction, such as: (i) urban streets and rural roads; (ii) autonomous water and sanitary sewerage systems; (iii) storm drains; (iv) social services such as education, health, child care, and community centers; (v) urban utilities such as integrated solid waste management and street lighting; (vi) urban equipment such as transit terminals, markets and slaughterhouses; (vii) environmental conservation and amelioration, flood and erosion control structures, parks and green spaces; (viii) local roads; and (ix) support for small and micro producers by building and equipping industrial and commercial premises⁶ and developing and implementing an information system on potential offerings of micro and small producers.
- 2.9 This component also would fund sanitary sewerage systems up to a total of US\$20 million, including sewer expansion or construction and efficiency improvements in sewage treatment plants in municipalities with populations under 100,000.

⁶ Basic premises with electricity and water service, suitable for fledgling microenterprises until they can consolidate their operations.

C. Scaling of the program and its cost and financing

- 2.10 The following factors were examined when deciding on the size of the program: (i) institution-strengthening needs of Paraná municipalities, associations of municipalities, and Paranácidade; (ii) the shortfall in municipal basic infrastructure spending as estimated from the list of municipalities' requests in Paranácidade totaling around US\$350 million; (iii) an analysis of projects relating to management and financing of public cultural goods sectors (US\$22 million); (iv) the municipalities' investment capacity, estimated from their capital spending in recent years that came to about US\$250 million annually, and their borrowing capacity, which would stand at US\$80 million a year; and (v) the institutional capacity of the Paraná State Department of Urban Development (SEDU) and of Paranácidade, the municipalities, and other participating state agencies to carry out the program, measured by reference to projects identified and prepared for the analysis of the operation described in this proposal.
- 2.11 The following table breaks out the program cost by item of expenditure and funding source.

Table II-1
Program cost table
(US\$ million)

ITEM AND CATEGORY OF EXPENDITURE		IDB/OC	LOCAL	TOTAL	%
1.	Administration and supervision (consultants, equipment)	0.5	3.5	4.0	2.4
1.1	General administration	-	1.5	1.5	
1.2	Implementation and evaluation support	-	2.0	2.0	
1.3	External audits	0.5	-	0.5	
2.	Direct investments	99.0	62.7	161.7	97.0
2.1	Municipal development (consultants, equipment)	3.5	7.5	11.0	6.6
2.1.1	Strengthening of Paranácidade	3.0	2.0	5.0	
2.1.2	Strengthening of the State Auditing Agency	0.5	0.5	1.0	
2.1.3	Institutional strengthening of municipalities, associations of municipalities, and civil society participation	-	5.0	5.0	
2.2	Modernization of management and financing of cultural public goods sectors (consultants, construction, equipment)	13.1	8.9	22.0	13.2
2.2.1	Modernization of management of State of Paraná cultural facilities	12.6	7.9	20.5	
2.2.2	Modernization of management of the rehabilitation of urban heritage sites	0.5	1.0	1.5	
2.3	Municipal basic infrastructure investments (consultants, equipment, construction projects)	81.9	46.8	128.7	77.2
2.3.1	Municipal works	61.9	46.8	108.7	
2.3.2	Sewer systems in municipalities with populations under 100,000	20.0	-	20.0	
Subtotal		99.0	66.7	165.7	99.4
3.	Financial charges	1.0	-	1.0	0.6
3.1	Inspection and supervision	1.0	-	1.0	
TOTAL		100.0	66.7	166.7	100.0
Percentage		60.0	40.0	100.0	-

III. PROGRAM IMPLEMENTATION

A. Borrower, guarantor, and executing agency

- 3.1 The borrower will be the State of Paraná, with the guarantee of the Federative Republic of Brazil. As executing agency the Paraná state government has designated Paranácidade, attached to the Paraná State Department of Urban Development—SEDU, which is in charge of developing and implementing the state's urban and regional development policies. Paranácidade's functions will be as follows: (i) institutional financial evaluation of municipalities; (ii) analysis of municipal institution-strengthening projects and technical, economic, financial, environmental, and institutional appraisal of investment projects; (iii) technical support to coexecuting agencies for project implementation; (iv) supervision, monitoring and audits of projects financed, and (v) administration of the program, including spending commitments and authorizing disbursements to municipalities.

B. Implementation of the Funding System for Activities of Municipalities in the State of Paraná—Paraná Urbano (SFM)

1. Executing agency

- 3.2 As was the case in the first Paraná Municipal Development Program (Paraná Urbano I or PPU-1), the executing agency for the SFM will be Paranácidade with the Paraná Development Agency (AFP) as financial agent, in accordance with a set of General Operating Regulations and Specific Operating Regulations for Paraná Urbano II agreed on with the Bank. Signature of agreements between the borrower and the AFP for that agency to lend to municipalities eligible under the program will be a condition precedent to the first disbursement.
- 3.3 Entry into force of the Paraná Urbano II-IDB Specific Operating Regulations will be a condition precedent to disbursement of the proposed loan.
- 3.4 Within 12 months after the effective date of the loan contract, the AFP is to have been put under the SEDU. Before the last disbursement under the loan contract the approach selected for bringing private funding into the SFM is to have been implemented.

2. Coexecuting agencies

- 3.5 The following paragraphs describe the other agencies that will take part in the program according to its decentralized implementation design.

a. Municipalities

- 3.6 The municipalities will be responsible for executing eligible institution-strengthening and investment projects. Investment projects will be devised using the consultation mechanisms already institutionalized in the municipalities, such as dialogues with community representatives and interest groups and other consultation arrangements that are viewed as necessary or appropriate in specific circumstances.

b. Associations of municipalities

- 3.7 These associations will be responsible for executing projects relating to the institution-strengthening component of the municipal development subprogram. They also will evaluate and approve municipal projects falling within the discretionary limits set by the program, and will be in charge of supervising program-funded works projects.

c. Empresa de Saneamento do Estado de Paraná (SANEPAR)

- 3.8 This state sanitation utility will be in charge of implementing sanitary sewerage projects in municipalities with populations under 100,000, in which it operates the sanitation services concession.

C. Documents governing the program

- 3.9 Apart from the loan contract to be signed between the State of Paraná and the Bank, the program would be governed by the following instruments.

1. Technical cooperation agreements

- 3.10 These agreements to be signed between SEDU and the State Department of Culture, SANEPAR, and the State Auditing Agency will spell out each agency's project execution responsibilities.

2. Agreements with municipalities and associations of municipalities

- 3.11 The program will use three kinds of agreements to govern its dealings with municipalities:
- a. **Participation agreement**, describing the general SFM objectives, funding anticipated at the outset for the municipality for four years, conditions for receiving the funds, and adherence to SFM rules and requirements.
 - b. **Agreement** between Paranácidade and the municipalities, specifying planned actions for the municipality and setting its fiscal, institution-strengthening, and investment targets.

- c. **Addendum to the agreement** between Paranácidade and the municipalities, to be drawn up for each works or institution-strengthening project. It will specify the funds allotted for the project and specific conditions with regard to funding sources.
- d. **Technical-financial cooperation agreement** between Paranácidade and the associations, setting out institutional actions to be implemented and services to be provided in executing the SFM.

3. Onlending of program resources

- 3.12 The program funds will be onlent to SANEPAR as subloans and to the municipalities via loans from the AFP, from its capitalization by the borrower.
- 3.13 Submittal of drafts of the agreements listed in paragraphs 3.10 to 3.12 for the Bank's approval will be a condition precedent to the first disbursement.

4. General Operating Regulations (GORs) for the Municipal Funding System

- 3.14 These SFM Regulations describe, *inter alia*, financial terms and conditions for subloans to municipalities and SANEPAR, how resources will be allocated to municipalities and participating state agencies, and eligibility criteria for municipalities, sectors and projects, and will contain models of the agreements. The key sections of the GORs are summarized below.

a. Allocation of program funds

- 3.15 The object of the proposed system for apportioning funds among municipalities is to make sure that municipalities with the weakest implementing capacity have access to funding at the outset, without compromising the full and timely use of resources by the more efficient municipalities.
- 3.16 SFM resources, including the proceeds of the proposed Bank loan, would be allocated annually among municipalities for a period of four years, by reference to the following principles: (a) the allocation would be pro rata to the municipalities' borrowing capacity and (b) allocations will consist of uncommitted resources from the previous year⁷ plus those planned for the four-year period.
- 3.17 The SFM resources will fund 100% of direct costs of works projects. However, if the cost of such a project exceeds the contract amount, the municipality will have to furnish the funds needed to complete the project.

⁷ Funds are deemed to be committed when a works, services, and/or procurement contract has been signed.

b. Eligibility criteria

(i) For municipalities

- 3.18 Any Paraná municipality will be eligible for the program if it: (a) is in compliance with borrowing and debt ratios and ceilings; (b) is complying with the institutional and fiscal targets set out in its agreement; (c) is in compliance with Fiscal Responsibility Act (LRF) provisions; (d) is complying with the covenants in agreements and subloan contracts signed under the SFM; and (e) belongs to an eligible association of municipalities.

(ii) For SANEPAR

- 3.19 Conditions for SANEPAR's eligibility are that it: (a) have a cash flow surplus; (b) be in compliance with the LRF; and (c) be complying with the covenants in agreements and subloan contracts signed under the SFM.

(iii) For associations of municipalities

- 3.20 Eligible associations of municipalities will be those that, in year 1 of the program: (a) have signed and are in compliance with an agreement to implement the institution-strengthening project for their association; (b) have adequate premises and enough staff with the required qualifications to analyze and supervise municipal projects; and (c) have resources of their own to fund their operation.
- 3.21 As of year 2, an association will be eligible if it: (a) has made the adjustments called for in the proposal for its institution-strengthening project; and (b) has signed and is complying with the agreement to provide technical assistance to member municipalities.

(iv) For projects and sectors of activity

- 3.22 The General Operating Regulations stipulate technical, economic, financial, environmental, social, and institutional criteria for each type of project. Table III-1 summarizes some examples.

Table III-1

SECTOR	ELIGIBILITY CRITERIA			
	Technical/Legal	Socioeconomic	Financial/ Institutional	Environmental
Urban roads	<ul style="list-style-type: none"> - Justify works in a road system explaining road selection criteria - Public hearing with 80% approval for viaducts - Study of alternatives - Geotechnical studies, dimensioning of solution, quantity estimating - Plane altimetric profile, traffic definition, geometric design - Designs, specifications, descriptive summary, budget, completion timetable - Maintenance plan 	<ul style="list-style-type: none"> - Analysis of land-register status of lots adjoining targeted streets - Cost-benefit analysis with internal economic rate of return (EIRR) >12% - Cost-efficiency guidelines, eastern region: ST2/ST3 ≤ R\$3,850, e ≤ 95 CMA ≤ R\$3,910, e ≤ 95; HMA ≤ R\$ 5,400, e ≤ 95; Irregular stone ≤ R\$3,850, e ≤ 95 Paving blocks ≤ R\$4,390, e ≤ 95 - Quantify beneficiaries 	<ul style="list-style-type: none"> - 70% cost recovery via betterment levy - Financial analysis of municipality's operating and maintenance budget 	See SCA Appendix 1 to GORs
Water supply	<ul style="list-style-type: none"> - Comply with NBR 9040/94 - System expansion adheres to municipal sanitation plan 	<ul style="list-style-type: none"> - Marginal cost ≤ US\$0.6/m³ for water supply projects 	<ul style="list-style-type: none"> - Autonomous utility - Rates recover all costs - Positive cash flow - Separate management accounting 	See SCA Appendix 1 to GORs
Sanitary sewerage and sewage treatment	<ul style="list-style-type: none"> - Comply with NBR 9040/94 - System expansion adheres to municipal sanitation plan - Comparative study of the proposed systems - For sewage treatment, study of alternatives of similar efficiency - Address impact of discharges into receiving body, per IAP and SUDERHSA requirements 	<ul style="list-style-type: none"> - (PVI + OAM) / number of connections in year 1 ≤ US\$1,000 - Case by case economic analysis using same methodology used in Paraná II sample for treatment efficiency increase: IRR (business plan) ≥ 12% 	<ul style="list-style-type: none"> - Service delivered by same utility in charge of water supply - Water and sewer rates recover all the utility's costs - Positive cash flow 	See SCA Appendix 1 to GORs
Education	<ul style="list-style-type: none"> - Siting and dimensioning study by reference to current and potential demand - Designs, specifications, descriptive summary, budget, completion timetable. Maintenance plan 	<ul style="list-style-type: none"> - Dimensioning and least-economic-cost solution - Quantify beneficiaries 	<ul style="list-style-type: none"> - Analysis of municipal finances 	See SCA Appendix 1 to GORs
Health posts (HPs) Simple and moderately complex projects	<ul style="list-style-type: none"> - Dimensioning, including private providers - Consider avoided transportation cost - Impact on morbidity and mortality - Equipment and provider alternatives 	<ul style="list-style-type: none"> - Analysis of investment alternatives - Submit Social Business and Maintenance Plan and demonstrate financial sustainability - Least-cost solution: ≤ US\$150/m² for type I HP ≤ US\$300/m² for type IV HP 	<ul style="list-style-type: none"> - Indicate sources of funding for Social Business Plan and describe its sustainability 	See SCA Appendix 1 to GORs
Rehabilitation of local roads	ADT < 100 in Region I – Arenito ADT < 200 in other regions	<ul style="list-style-type: none"> - CB: EIRR > 12% calc. by HDM - Quantify beneficiaries, value of time 	Financial analysis	See SCA Appendix 1 to GORs
Paving of local roads	ADT > 100 in Region I – Arenito ADT > 200 in other regions ADT < 400 in all cases	<ul style="list-style-type: none"> - CB: EIRR > 12% calc. by HDM - Quantify beneficiaries, value of time 	Financial analysis	See SCA Appendix 1 to GORs

ADT average daily traffic

CB cost-benefit

CMA cold-mix asphalt

EIRR internal economic rate of return

GORs General Operating Regulations

HDM Highway Design and Maintenance Model

HMA hot-mix asphalt

HPs health posts

IAP Paraná Environmental Agency

IRR internal rate of return

OAM operation and maintenance

PVI present value of investment

SCA Environmental Control System

ST2, ST3 2 (3) course surface treatment

SUDERHSA Water Res. & Envir.Sanit.Superintendency

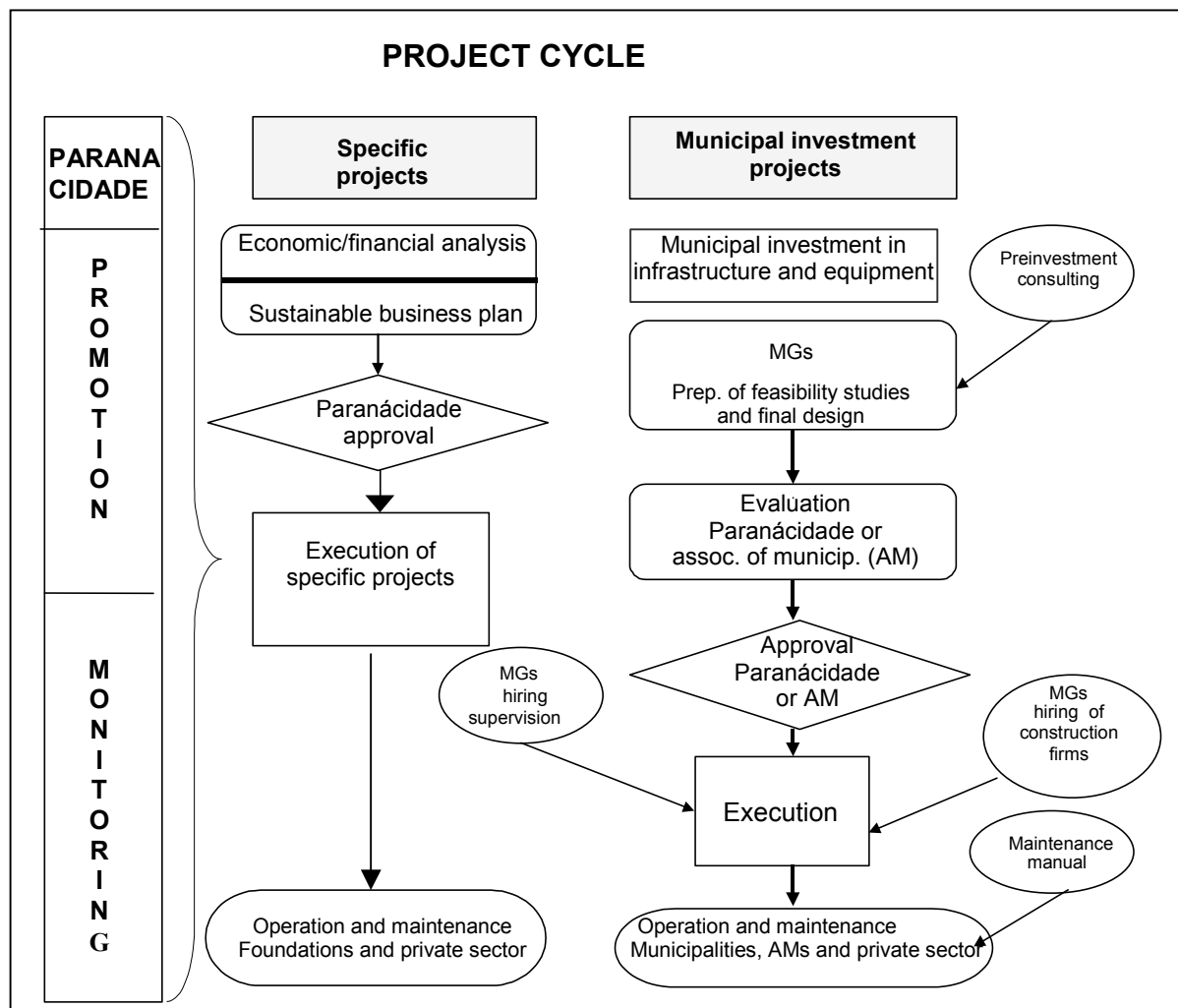
c. Financial terms and conditions of subloans to SANEPAR and AFP loans to municipalities

- 3.23 Financial terms and conditions of subloan contracts are as follows: (a) **grace period**: 12 months running from the date of first disbursement; (b) **repayment term including grace period**: up to 10 years; (c) **interest rate**: long-term interest rate for the quarter set by the National Monetary Board and published by the Central Bank of Brazil, adjusted annually, plus an 8% spread; (d) **municipal borrowing security**: share of ICMS tax received from the state; and (e) **SANEPAR security**: water and sewer rate revenues.

d. The project cycle

- 3.24 The flowchart below illustrates the project cycle in the program.

Figure III-1



(i) Promotion of the program

- 3.25 The plan is to start off the promotional activities with program launch seminars, inviting municipal executives and civil society representatives to learn about the features of this operation and its operating rules.

(ii) Project approval

- 3.26 Paranácidade will be in charge of project appraisals, using criteria in the General Operating Regulations. For public utility infrastructure projects those regulations will include approval by the utility administrator. However, Paranácidade may delegate this function to its regional offices and to associations of municipalities, with the following thresholds: (a) to an association of municipalities: projects costing up to US\$200,000; (b) to a regional office: projects costing more than US\$200,000 and less than US\$1 million.

(iii) Project execution

- 3.27 Before bids can be called for a project the municipality must: (a) have signed the respective addendum to its agreement with Paranácidade; (b) secure an environmental setup permit from the Paraná Environmental Agency and comply with any conditions that agency prescribes; and (c) demonstrate the public consultation process, starting with information about the project to the affected community, one month before tenders are called.
- 3.28 In addition, before a construction, consulting, or equipment procurement contract can be signed, the municipality must have signed the respective subloan contracts with the SFM financial agent.
- 3.29 Likewise, before any works project begins, the municipality must demonstrate that public utility companies which may be affected by the works have pledged to cooperate and expedite their execution.

(iv) Inspection and supervision of works projects

- 3.30 Construction audits will be the responsibility of the municipality or contracting state agency, using consultants or specialized firms. The works projects will be supervised by Paranácidade, which may hire an association of municipalities for the task.

e. Cost recovery arrangements

- 3.31 A works project's operating, administrative, maintenance, and capital costs are to be recovered through revenues raised by the municipality, state, or utility or service provider from taxes, rates, betterment levies, rent, concession fees, etc., that they charge according to the law. When a project's beneficiaries cannot be clearly

identified, no discrimination would be justified, or the beneficiaries' socioeconomic situation so warrants, the municipality's or the state's general revenues can be used for cost recovery. In such cases it must be demonstrated that the project will not create a primary deficit in the municipality's or state's finances.

5. Specific Operating Regulations for the Paraná Urbano/IDB program

- 3.32 These regulations itemize Bank requirements relating to the proposed loan, covering the following topics:

a. Procurement

(i) Goods, construction work and services

- 3.33 In keeping with Bank policies, international competitive bidding will be required when a contract estimate is US\$5 million equivalent or more for construction work or US\$350,000 or more for equipment purchases. Annex III-1 to this proposal contains the program's procurement plan.

(ii) Consulting services

- 3.34 Consulting services will be selected and engaged following Bank procedures. International competitive bidding will be required when the estimated value of a contract with a firm exceeds the equivalent of US\$200,000. Price may be used as a criterion for consultant service selection. When the decision is based on a combination of best price and best technical proposal, the maximum weighting for price will be 20% and the minimum weighting for the technical proposal will be 80%.

(iii) Thresholds for procurement with ex post review

- 3.35 The proposed program will require numerous contracts. To expedite the program and facilitate supervision work, at the Country Office's discretion it may work out an agreement with the executing agency to the effect that procurement operations worth up to US\$5 million for works, up to US\$350,000 for equipment and goods, up to US\$100,000 for consulting firms, and up to US\$50,000 to hire individual consultants will be reviewed ex post by sampling.
- 3.36 The above-mentioned thresholds may be lowered as a result of annual evaluations of the program.

b. Conditions precedent to tendering of a works project

- 3.37 As a further condition for tendering of a works project, the municipality, SANEPAR or the state department in charge of the project must provide

Paraná with: (a) detailed designs of the works and (b) evidence that Paraná Environmental Agency requirements have been satisfied.

c. Operation and maintenance

- 3.38 Measures required (and acceptable to the Bank) to maintain program-funded works and equipment in accordance with generally accepted technical standards must be adopted. Such maintenance may be direct, in the case of program-funded works and equipment owned and operated by the state, or through agreements executed with municipalities if a municipality is responsible for operation of the works or equipment. If, from inspections it performs or reports it receives, the Bank ascertains that operation and maintenance are not up to the agreed standard, the state or the municipality will be required to see that measures needed to completely remedy such deficiencies are adopted.

d. Advances of funds, reimbursement of payments and accounting for funds expended

- 3.39 Funds will be advanced and payments reimbursed following Bank rules. A revolving fund equal to 5% of the proposed loan would be set up.
- 3.40 The executing agency will be accountable to the Bank for: (i) implementing and maintaining sound contract administration, accounting-financial management, and internal control systems to handle program funds pursuant to clause 7.01 of the General Conditions of loan contracts; (ii) submittal of disbursement requests and justifications of expenditures in accordance with Bank requirements; (iii) presentation of semiannual reports on the Revolving Fund, within 60 days after the end of each six-month period; (iv) preparation and presentation of the program's consolidated financial statements and any other financial report requested by the Bank; and (v) operation of separate bank accounts exclusively to handle the loan proceeds and the local counterpart funds. In addition, in the agreements the executing agency signs with coexecuting agencies the latter must undertake to: (i) account to the executing agency for funds received and prepare financial reports on request; (ii) maintain complete and accurate accounting and financial records on the use of program funds; (iii) maintain complete and accurate files of supporting documents for contracts awarded and expenditures incurred using the loan proceeds and counterpart funds, and make such records available for review by external auditors and Bank employees; and (iv) operate separate bank accounts exclusively to handle the loan proceeds and counterpart funds.
- 3.41 Because of the program's decentralized design, supporting documentation for disbursement requests sent to the Bank will be reviewed ex post. The executing agency will send the Bank the disbursement request along with a Control of Disbursements and Local Contributions form and a breakdown of payments following a format agreed on with the Country Office. The executing agency and/or

coexecuting agencies will keep original payment documents (receipts, invoices, etc.) on file and make them available to Bank staff and external auditors during inspections.

D. Recognition of expenditures

- 3.42 The executing agency has incurred a series of expenditures to prepare the operation proposed here and to execute works projects. The anticipated total outlay between 18 October 2001 and approval of the loan is US\$15 million. This sum will be charged against the local counterpart provided that procedures substantially similar to the procedures that will be prescribed in the loan contract have been followed.

E. Program monitoring

1. Monitoring by the Bank

- 3.43 The program will be supervised by the Bank's Country Office in Brazil. Two items that will come in for particular attention are compliance with the project preparation and implementation conditions in the Operating Regulations and compliance with eligibility criteria for municipalities.

2. Semiannual progress reports

- 3.44 The executing agency, on the borrower's behalf, will provide the Bank with semiannual status reports on the program, indicating actions and activities completed, outputs and outcomes, targets achieved, and any serious problems encountered and solutions proposed. The reports also will state the funds expended by component and compare programmed and actual expenditures. The report format is to be agreed on in advance with the Country Office.

3. Annual reviews and work plans

- 3.45 Within the first four months of each year the executing agency and the Bank will review the program's status, looking at the second-half progress report. The annual work plan for the current year to be agreed on during these reviews will adjust activities and targets and map out the program to its completion. The yardstick to be used both in the annual reviews and the annual work plans will be fulfillment of the commitments stipulated in the program's Logical Framework (Annex II-1).

4. Evaluation of the program

- 3.46 Ninety days after each fiscal year-end, the executing agency, on the borrower's behalf, will provide the Bank with a program evaluation report produced by an independent outside agency. The evaluation will analyze, in particular, the impact of the SFM using the methodology agreed on with the Bank, by reference to

monitoring studies, the program's Logical Framework indicators,⁸ and other agreed tools. The evaluation, including construction of the baseline, is to be commissioned within nine months after the effective date of the loan contract, in accordance with terms of reference approved by the Bank. The cost of these evaluations will be defrayed with program funds.

Table III-2
Evaluation criteria and methodology for the program

The evaluation will be based on two indicators: a disparity indicator given by the Gini coefficient of the Index of Supply of Public Services for the municipality (IOSP) and a public services supply improvement indicator, to be defined through an analysis of improvements in average IOSP of each cluster of municipalities in the IOSP ranking. That indicator is used to assess municipalities' relative standing in terms of supply of services that the program will support in the health, education, urban development, social, and fiscal efficiency sectors. The IOSP is a simple average of the Relative Shortfall Index (ICR) of the variables that comprise it. The partial ICR of a given variable for a cluster of municipalities can be expressed as:

$$ICR_i = \frac{(X_i - X_{\min})}{(X_{\max} - X_{\min})}, \text{ where:}$$

X_i = position of the ICR of the partial variable considered in municipality (i);

X_{\max} = value of ICR of the municipality ranking highest for this variable;

X_{\min} = value of ICR of the municipality ranking lowest for this variable.

Changing the variable into a measure of "relative shortfall" makes it possible to standardize and aggregate it, to develop a composite index represented by the simple geometric mean of the measure of relative shortfall in four variables: education, health, urban development, and fiscal efficiency, measured by:

$$IOSP_i = \sqrt[4]{\prod_{N=1}^4 (ICR_i)_n} \quad \text{where:}$$

$IOSP_i$ = IOSP for municipality i; N = number of variables in the composite IOSP.

The IOSP is made up of 5 ICRs: 1. **education**: enrollment rate for the 7-14 age group; 2. **health care**: ambulatory procedures per capita per year and complete coverage of the vaccination cycle; 3. **urban development**: average ICRs: sanitation, drainage and paving; 4. **social services**: coverage of such services as day care centers, community centers, etc.; and 5. **fiscal efficiency**: municipal tax, levy and rate revenues as a percentage of municipal GDP.

- 3.47 In addition, based on the evaluation reports referred to in the preceding paragraph, two years after the effective date of the contract the Bank will conduct a midterm review of the program to ascertain the status of the Logical Framework indicators and targets.

F. External audits

- 3.48 The executing agency will submit the program's annual financial statements to the Bank within 120 days after each fiscal year-end, after they are audited by an outside

⁸ Specifically: indicators as to reductions in service deficits; implementation of the Results-based Management Program; strengthening of associations of municipalities; municipal ranking; percentage of private funding in the SFM, and operation of Paránacultura, Artes de Paraná, and the Paraná Art Gallery.

independent audit firm in accordance with Bank requirements. The executing agency also will provide the Bank with a semiannual operational and financial audit report on the program within 60 days after the end of each six-month period, including a specific report on the review of disbursement requests submitted to the Bank. The audit terms of reference are to be approved in advance by the Bank.

G. Final evaluation

- 3.49 It was agreed with the borrower that an ex post evaluation would be done of the program. To that end, six months after the date of the last disbursement of the loan, the executing agency, on the borrower's behalf, will provide the Bank with an ex post evaluation report on the program's impacts, using information from the annual evaluations and any additional information needed to produce the evaluation.

IV. VIABILITY AND RISKS

A. Institutional and financial viability of the program

1. Paranácidade

4.1 The creation of Paranácidade was a signal achievement of the previous program.

That agency assumed a key role in the program's execution, as manager of the first municipal development program (Paraná Urbano I) and of the State Urban Development Fund and in providing institutional and technical support to municipalities and associations of municipalities. Paranácidade developed a Project Monitoring System (SAM) to track the program activities. With that system, coupled with the Financial Management System,⁹ every stage of a project can be monitored, with updated information on the Internet regarding

tendering procedures. Specifically, the level of development, operation, integration and coverage of its analysis, monitoring and operations control systems affords assurances that the new phase will be institutionally and financially viable, that there will be adequate controls over the main coexecuting agencies, municipalities and associations of municipalities,¹⁰ and that procedures will be transparent.

Table IV-1
Paranácidade systems

System	Purpose	Status: (1) Operational (2) Development (3) Phase II
SAM – Project Monitoring System	Monitor projects funded by the agency at every stage	1
SGF – Financial Management System	Financial control of contracts and loans for all the agency's programs	1
SIMGEO – Georeferenced Land-Register System	Create and add to municipal land-register databases to eventually launch them with digital mapping for geoprocessing	2
SIMPRECIOS – Tendering Cost Monitoring System	Monitor market prices and prices charged in projects financed by the agency	2
SIMDIV – For borrowing capacity estimating	Estimate municipalities' borrowing and debt capacity	3
SIMRISC – Client and project risk	Assess borrower and project financing risks	3
SIMPGR – Reporting system for results-based programming	Integrate data required by Results-based Management Program and State of Paraná Auditing Agency	3

⁹ These are all corporate systems using a shared database, allowing for interactive resource use.

¹⁰ The managerial, technical and administrative capabilities of 18 associations of municipalities, with an average membership of 22 municipalities, were strengthened. Today they are developing projects, measuring construction, and participating in priority-setting with communities. Close to 60% of works projects were under these associations' control and responsibility.

2. SANEPAR

4.2 SANEPAR, the state sanitation utility, is a public/private corporation controlled by the Paraná state government. Since June 1998, approximately 40% of its voting capital stock has been acquired by a strategic partner, formed by a consortium of Brazilian and foreign companies. SANEPAR holds the water and sewer concession for 342 of the state's 399 municipalities. It has 3,933 employees. From 1998 to 2001 the number of water and sewer connections per employee climbed from 569 to 683. The company's return on net equity rose over that same interval from 4.2% to 14.3%. In 2001 its capital investments topped US\$100 million, the highest in its 39 years of operation. SANEPAR also has been developing new products, including water delivery, treatment of industrial effluent and integrated management of urban solid waste collection, treatment and disposal.

4.3 An analysis was done of SANEPAR's financial statements from recent years audited by independent external auditors, and of the company's 10-year financial forecasts. It was

concluded that SANEPAR satisfies the requirements of the Bank's sanitation sector policy, can furnish the requisite counterpart funds, and is able to pay back loans it would receive under the

Table IV-2
SANEPAR credit rating

Moody's Investment Services put SANEPAR at the top of the national rating scale (Aaa.br), signaling a low risk for investors. This year SANEPAR secured the first paid concession contract signed between a state sanitation company and a Brazilian state capital. The concession cost of R\$125 million (about US\$50 million) will be paid over the term of the concession arrangement.

program. However, the state does not have an independent regulator for this service as the policy requires. That deficiency notwithstanding, the governor has the authority to approve SANEPAR rates via executive orders, including the requirement that the company continue to offer a reduced rate for low-income customers. That arrangement has been working satisfactorily, with no complaints from customers or the private strategic partner.

3. Management and financing of public cultural goods

4.4 Support for the consolidation of management mechanisms in this sector: The general concept of the planned State Cultural System is in line with international best practices in which the sustainability of such activities is premised upon a concerted effort by all social actors, to enable cultural institutions to capture private funds and use their holdings and facilities to generate additional funds. The draft legislation and by-laws of the new institutions that would form part of the State Cultural System are adequate to achieve these objectives. It has been agreed that program funds would be allocated to help produce business plans for the new agencies that will be managing the restructured cultural institutions. By virtue of its terms of reference the executing agency will be able to help consolidate the proposed management schemes.

4. State of Paraná

- 4.5 The State of Paraná will furnish counterpart funds for the program, using State Urban Development Fund resources. The counterpart requirement for the four-year program will come to about US\$17 million a year. Since this is equal to 33% of the roughly US\$50 million the aforementioned Fund has been generating and onlending to municipalities in recent years, there would be no problems in counterpart fund availability.
- 4.6 The state government has made a resolute fiscal effort both by containing growth in current spending and by generating fresh funds through a major overhaul of state finances. As part of this adjustment process the state rescheduled its largest debts with the federal government and privatized the state bank. The agreement signed with the federal government sets mandatory fiscal targets for the state including ratios of debt stock to net revenues, payroll costs to net revenues, and primary-surplus requirements.

Table IV-3
State of Paraná: Fiscal situation 2000/2001 and 2000-2010 program
(US\$ million)

	2000	2001	2002	2005	2010
1. Gross revenues	3,536	3,110	3,351	3,609	4,094
1.1 Transfers to municipalities	705	613	675	782	936
2. Net revenues (1-1.1)	2,831	2,497	2,676	2,827	3,158
3. Current expenditure	2,455	2,312	2,126	2,141	2,669
3.1 Payroll	1,648	1,512	1,600	1,695	1,835
4. Primary surplus (2-3)	376	185	550	686	489
5. Debt service	1,265	323	325	318	312
6. Borrowing requirement	1,808	138	130	123	-
Targets and results in percentages:					
- Primary balance/Net revenues $\geq 0\%$	13.3	7.4	20.5	24.3	15.5
- Payroll costs/Net revenues $\leq 60\%$	58.2	60.0	60.0	60.0	58.0

- 4.7 The state has made satisfactory progress toward these targets and in fact has exceeded some of them thanks to its fiscal effort and economic conditions in the past two years. Some of this can be attributed to the implementation of the financial management project funded in part by the Bank.¹¹
- 4.8 The operation proposed here would fit within the state's borrowing and debt ceilings under the above-mentioned debt rescheduling agreement. Accordingly, the state will be in a position to honor its counterpart-funding commitments for this program and service its debt. To sum up the analysis findings: (i) there would no problem with counterpart funds because there are adequate resources in the State

¹¹ National Program for State Fiscal Management, loan 980/OC-BR.

Urban Development Fund plus funds from the increase in state ICMS tax revenues and constitutionally mandated federal government transfers; and (ii) thanks to improvements in the State of Paraná's finances following adjustment and reform measures, the state will be able to duly service its debt to the Bank.

B. Technical viability of the program

1. Technical feasibility of specific works projects

- 4.9 The executing agency has designs for all the specific projects. The mission reviewed detailed designs and construction and equipment estimates for projects to remodel, expand and outfit cultural facilities, and agreed on adjustments needed to adhere to the principle of cost-efficiency in achieving project objectives. These include: (i) for the Paraná Museum project, adding equipment needed to provide support through the state Internet network; (ii) adjusting the layout of the Art Gallery remodeling designs to match the business plan; and (iii) adjustments to the design for the Canal da Música building remodeling project to meet requirements of the organizations that will be housed there and fit within the budget. Once those changes are made these projects would be ready to put out to tender. The executing agency has the necessary urban planning opinions and approvals to execute the investments.
- 4.10 Agreement also has been reached on guidelines for the design of mechanisms for restoring urban heritage sites. These are in line with international best practices and the Bank's technical guidelines in this area, such as: (i) arrangements for calls for proposals to select significant state-protected heritage sites to benefit from the pilot rehabilitation investments, and (ii) the requirement that selection criteria favor private-sector involvement in investment-project funding.

C. Technical, socioeconomic and financial viability of projects

1. Investment subprogram: Findings of the technical analysis

- 4.11 The analysis presented in this section is limited to the analysis mission's verification of compliance with specific technical and environmental criteria for projects proposed by the General Operating Regulations, which are consistent with current project analysis techniques.

2. Findings of the socioeconomic and financial appraisal of projects

- 4.12 The following table presents the economic returns of operations in the sample of new projects.

Table IV-4
Economic appraisal of projects¹²
(in US\$000 at economic prices)

PROJECT TYPE	Municipality	Benefits ¹³	Investment	OAM costs ¹⁴	Net benefits	EIRR (%)
Museums and cultural facilities						
Art Gallery	RMC*	7,882	4,349	2,833	699	14.3
Canal da Música	RMC	22,346	1,160	2,981	18,204	212.1
Cinemas	Various non RMC	13,405	8,413	1,735	3,256	17.6
Sanitary sewerage						
System implementation	Nova Londrina	1,136	522	218	395	22.7
	Sta. Te.d Itaipú	1,257	671	275	310	18.8
	S. M. Iguaçu	817	525	174	118	15.4
	Itaipulândia	492	281	104	106	18.2
	Nova Aurora	534	381	122	30	13.3
System expansion	Loanda	959	527	105	326	21.4
	Campo Mourão	1,001	415	105	481	29.0
	Toledo	783	855	81	333	22.6
	Palotina	852	475	76	301	20.9
	Goioêre	928	458	96	373	24.2
Treatment efficiency	Jacarezinho	2,138	901	205	1,032	28.9
	Andirá	954	496	88	370	23.2
	Florai	280	200	26	54	16.3
Local roads / Segment						
BR 476/C.Red/L. Gran17 km	Araucária	5,026	1,730		3,296	29.0
Sede/Pombas 4.9 km	Itaperuçu	371	459		88	10
PR 160/Vera Guarani 5.6 km	Paulo Frontin	404	338		66	14
PR 218/Icatu 3.6 km	Querência d.N.	377	106		271	35
PR 092/Patr.S Miguel 5.5 km	Wencesl. Braz	561	412		148	16

*RMC Curitiba Metropolitan Region

D. Environmental and social viability

- 4.13 Investments funded by the program will have positive environmental and social impacts, which will vary by sector. Generally, they will: (i) improve quality of life and public health indicators following the execution of targeted social services projects, and (ii) improve environmental conditions in the state as the impact of solid waste and sewage is lessened, environmental liabilities are eliminated, land-

¹² Conversion factors: Standard = 0.96; unskilled labor = 0.45; skilled labor = 0.96; electric power = 0.88 BDI = 0.40.

¹³ Surveys of willingness to pay were used to quantify benefits of cultural, historical heritage and sanitation projects. As a nonparametric model analysts used the Turnbull method proposed by McConnell (K.E. McConnell, *Issues in Estimating Benefits with Non-Market Methods*, Office of the Chief Economist. Working Paper Series 308. Inter-American Development Bank, Washington, D.C., 1995). For local roads projects, analysts used cost savings in the Highway Design and Maintenance Model.

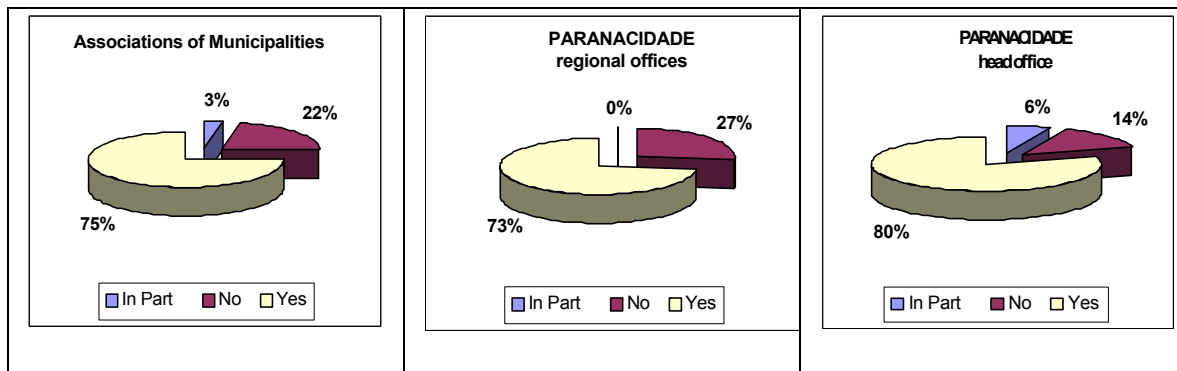
¹⁴ Corresponding to the business plan that funds expected and desired sustainable service delivery levels.

use plans are instituted and associations of municipalities are strengthened in the environmental protection area. Any adverse environmental or social impacts of the projects would be localized and generally minimal. There are provisions in the Environmental Control System to remedy any such problem.

- 4.14 According to the ex post evaluation of the first phase of the program (PPU-I), that operation improved the environment and quality of life in Paraná towns and cities. Close to US\$1.7 million, or 18% of total investments examined in the ex post sampling, were for projects designed to directly improve the environment and mitigate environmental impacts. Among the projects funded were five new land-use plans and 38 rewrites of existing plans. Urban mapping activities included tree planting, parks and streams. Municipal employees were trained to apply the Project Monitoring System procedures. The executing agency received continual support from the Paraná Environmental Agency, which issues permits, analyzes, and tracks implementation and operation of the funded works. A noteworthy achievement was the financing of US\$23 million in targeted social services projects such as health posts and day care centers. No projects entailed involuntary or voluntary resettlements.

Figure IV-1

**Compliance with Paraná Urbano I environmental requirements, by
evaluating and approval office**



- 4.15 The environmental component of the PPU-1 project ex post evaluation also revealed information that helped guide the proposal for the loan described here. The analysis of adherence to environmental guidelines by sector found that 71% of projects had obtained all the required documentation and 88% had implemented the specific environmental measures prescribed. In instances in which some guidelines had not been satisfied there had been no significant adverse impact on the environment. As Figure IV-1 illustrates, environmental compliance is strongest for Paranacidade headquarters—and it is precisely at head office that the larger, heavier-impact projects are evaluated.

- 4.16 In light of these ex post evaluation findings and the features of the new program proposed here, the following environmental measures are being taken: (i) the environmental procedure titled “Environmental Control System” (SCA) contained in Appendix 2 to the Specific Operating Regulations has been updated; (ii) new environmental and social eligibility criteria have been added and these guidelines have been made more specific, and guidelines were set for the new sectors of heritage restoration and local roads; (iii) there are provisions for complying with the community impact assessment requirement under Federal Law 10,257 (10 July 2001), known as the “Cities Act”; (iv) periodic training in application of the SCA will be provided (once a year, to begin with) for technical officers of municipalities, associations of municipalities and Paran cidade offices; (v) independent audit arrangements will be strengthened to contain expeditious ways of verifying implementation of environmental guidelines during construction and for conservation, maintenance, and implementation of environmental measures (environmental management or social action plans) planned for the operating phase; (vi) the Project Monitoring System will be updated; and (vii) a list of specific environmental indicators (see SCA) has been included, to report in annual monitoring reports to the Bank. The planned environmental strengthening activities come to US\$71,000 (see SCA).
- 4.17 In addition to promoting improvements in quality of life and social indicators, the program will help enhance social equity by fostering private local economic activity with support for microentrepreneurs and small-business owners and other initiatives.

E. Benefits

- 4.18 The proposed program will improve the coverage and quality of services that Paran  municipalities deliver to their residents, primarily the low-income population, through urban and social infrastructure rehabilitation and expansion projects that offer sound economic returns.
- 4.19 The program will yield more aggregated benefits by bringing private capital into municipal finance, making for better and more transparent municipal resource allocation and use, giving civil society a greater say in municipal resource allocation, and achieving investment efficiency gains.
- 4.20 The program will improve the delivery of public goods and those with strong externalities through incentives to correct these market failings, notably in the areas of local roads, cultural goods, and restoration of the state’s historic heritage.

F. Targeting

- 4.21 **Poverty targeting.** The yardstick for the poverty targeting analysis of the proposed program was the poverty line of R\$140 per capita per month (in 2001 prices) or R\$470 per household per month. From the national household sampling survey data the number of households per income bracket in metropolitan Curitiba (RMC) and for the state as a whole (the difference) were obtained. Taking a household occupancy rate of

Table IV-5

MONTHLY HOUSEHOLD INCOME MINIMUM SALARIES	CURITIBA METROPOLITAN REGION			REST OF STATE		
	House- holds (000)	Mean household monthly income (R\$)	Per capita monthly income (R\$)	House- holds (000)	Mean household monthly income (R\$)	Per capita monthly income (R\$)
TOTAL	725.9	1,309	387	1,408.7	941	264
From 0 ≤ to 2	30.0	117	35	128.1	117	33
From 2 ≤ to 3	53.8	222	66	223.3	218	61
From 3 ≤ to 4	81.4	349	103	195.3	338	95
From 2 ≤ to 5	135.7	541	160	286.9	535	150
From 5 ≤ to 10	200.5	958	283	303.3	978	275
From 10 ≤ to 20	109.9	1,891	559	156.1	1,901	534
From 20 a +	72.6	5,491	1,625	86.9	5,115	1,437
No income	15.4	-	-	19.4	-	-
Not reported	26.6	-	-	9.4	-	-

Source: 1999 National Household Survey

3.38 persons in the RMC and 3.56 in other Paraná municipalities the percentage of households below the poverty line was obtained. As the accompanying table shows, 38.4% of RMC households and 57.1% of households elsewhere in the state fall below the poverty line. Since most of the program's investments will be executed outside the RMC, the operation would qualify as a poverty targeted investment. However, the State of Paraná is not requesting the 10 percentage points in additional financing.

G. Risks

- 4.22 Despite the changes successfully implemented by the State of Paraná in recent years, there always is some risk of a reversal of course due to their impact on political and economic interests. In particular, the new borrowing and transparent resource allocation system strengthened local communities and authorities in investment decision-making at the expense of "parliamentary initiatives", which are entirely discretionary. Moreover, the privatization of financing, which ensures that more funds and investments are available, has been strongly criticized for ignoring externalities and in some cases spillovers of the benefits of certain types of goods, such as public goods, that could result in an undersupply of the goods.

- 4.23 The program therefore includes a strategy and activities to offset the risk of any such reversal. Bringing the private sector into municipal finance will be a significant step forward in attracting private capital to the sector, which likewise will reduce any risk of a reversal of course.
- 4.24 With regard to the undersupply of public goods, the program views the component for modernization of management and funding of public cultural goods as a reform of state activities precisely to address these issues.
- 4.25 Private partners' contributions to the operation and maintenance of cultural facilities may be insufficient to cover all the costs. In that scenario the state government will put in additional contributions to make up the shortfall and ensure that the facilities are properly operated and maintained. This commitment will be covenanted in the contract.

PARANÁ URBANO II PROGRAM LOGICAL FRAMEWORK

OBJECTIVES	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
GOAL Foster improvements in quality of life of residents of the state of Paraná.	<ul style="list-style-type: none"> Quality and coverage of services delivered by municipal governments. Quality and coverage of cultural services provided by state agencies, and state of conservation of Paraná's historical heritage. 	<ul style="list-style-type: none"> Index of Supply of Public Services (IOSP). Public surveys on the quality of municipal services. Annual evaluation reports on the program. 	<ul style="list-style-type: none"> Sustainable municipal growth capacity. A stable national economy.
PURPOSE Improve the municipal finance model by bringing in more private capital; strengthening institutional capacity of municipalities and associations of municipalities; modernizing management and introducing incentives in sectors with strong externalities and spillovers (local roads, cultural infrastructure, restoration of urban heritage sites); improving municipal investment priority setting with civil society participation; and improving the quality and coverage of basic municipal services.	<ul style="list-style-type: none"> Paraná Development Agency placed under the State Department of Urban Development (SEDU) and SFM [Funding System for Activities of Paraná Municipalities] operating with private capital by June 2004. Results-based Management Program implemented in all municipalities; all associations strengthened and financially autonomous. 10% reduction in service deficits All municipalities have adjusted to meet Fiscal Responsibility Act¹ requirements. The first municipal ranking has been publicly released by December 2003. Participatory methodology with fiscal accountability for municipal investment priority-setting has been implemented in 50% of municipalities. 	<ul style="list-style-type: none"> Reports from SEDU, the State Auditing Agency and Paraná municipalities. Inspection visits. Program progress reports. Newspapers with a wide circulation in the state. Annual evaluation reports on the program. 	<ul style="list-style-type: none"> Commitment by local and state authorities. Communities continue to participate in local decision-making. Political will of city council officials

¹ Compliance with fiscal and budget provisions is monitored monthly and annually by the State of Paraná Auditing Agency. Requirements involving municipal debt and borrowing are monitored by the Central Bank, which authorizes municipalities for each project to be funded by the program. Apart from tracking the aforementioned elements, Paranácidade also assists municipalities with all the arrangements required to obtain loans and to comply with the Fiscal Responsibility Act.

COMPONENTS	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS
1. Municipal development			
a. Institutional strengthening of Paranácidade			
(i) Paranácidade certified as a fund manager by Standard & Poors. (ii) Studies to define an approach to bring private capital into municipal finance, and implementation of the alternative. (iii) Studies on alternatives to keeping the ICMS tax as municipal security for borrowings. (iv) Development of a borrower and project risk assessment model. (v) Development of a model to estimate municipalities' fiscal potential. (vi) Development and implementation of a municipal ranking system.	<ul style="list-style-type: none"> • Certification issued. • SFM 40% privately funded by June 2004. • Study approved and alternative loan-security arrangements in use by December 2004. • Model developed and implemented by December 2003. • Model developed and implemented by December 2002. • Ranking system developed and implemented by June 2003. 	<ul style="list-style-type: none"> • Program progress reports. 	
b. Strengthening of the State Auditing Agency			
(i) Computer hardware purchases (ii) Software purchases (iii) Systems development (iv) Training	<ul style="list-style-type: none"> • 4 network servers, 188 PCs, 70 software packages purchased; 100 Auditing Agency auditors and 1,500 municipal employees trained in the Municipal Reporting System/Results-based Management Program by July 2004. 	<ul style="list-style-type: none"> • Program progress reports. 	
c. Strengthening of municipalities and associations of municipalities			
(i) Implementation of Results-based Management Program (PGR) (ii) Management of primary balances (iii) Mapping (iv) Training of municipal employees	<ul style="list-style-type: none"> • PGR implemented in 204 municipalities by July 2003 and 399 by December 2004. • System implemented in SEDU by June 2003. • 75% of municipalities have a digitized urban mapping base by July 2004; property rolls implemented by December 2005. • 1,000 municipal employees trained per year from 2002-2005. 	<ul style="list-style-type: none"> • Program progress reports. 	

COMPONENTS	INDICATORS	MEANS OF VERIFICATION	ASSUMPTIONS								
(v) Strengthening of associations (vi) Four pilot projects for civil society participation. (vii)Preparation of studies.	<ul style="list-style-type: none">At least 10 projects in multi-municipality consortia implemented by December 2004.Four pilot projects implemented by June 2003.Four technical studies produced and published annually.										
2. Modernization of management and funding of public cultural goods											
a. Support for strengthening of management mechanisms											
(i) Startup of Paran�cultura and the civil society organization “Artes de Paran�” (A-PAR), with their business plans. (ii) Renovation, expansion and additional equipment for Castello Branco building, site of Paran� Art Gallery. (iii) Refurbishing of 14 cinemas existing in the state interior. (iv) Design of sustainable mechanisms for urban heritage preservation	<ul style="list-style-type: none">Paran�cultura and “Artes de Paran�” operating by December 2003.Museum operating by December 2003.<table><tr><td>2002</td><td>2003</td><td>2004</td><td>2005</td></tr><tr><td>3</td><td>4</td><td>5</td><td>2</td></tr></table>Mechanisms designed by June 2003. One pilot project executed by June 2005.	2002	2003	2004	2005	3	4	5	2	<ul style="list-style-type: none">Program progress reports.Program progress reports.Evaluation reports.	
2002	2003	2004	2005								
3	4	5	2								
3. Municipal basic infrastructure investments											
a. Sanitation projects in cities with populations under 100,000	<table><tr><td>2002</td><td>2003</td><td>2004</td><td>2005</td></tr></table>	2002	2003	2004	2005	<ul style="list-style-type: none">Program progress reports	<ul style="list-style-type: none">Paran� Sanitation Company (SANEPAR) has borrowing capacity and is in compliance with covenants of previous agreements signed under the scope of the program.				
2002	2003	2004	2005								
(i) Elimination of environmental liabilities (ii) Implementation and expansion of sanitary sewer systems	<table><tr><td>2</td><td>2</td><td></td><td></td></tr><tr><td>9</td><td>9</td><td>9</td><td>9</td></tr></table>	2	2					9	9	9	9
2	2										
9	9	9	9								
b. Municipal investments											
(i) Works implemented, operating and being maintained up to the apposite technical standards.	<table><tr><td>200</td><td>300</td><td>500</td><td>500</td></tr></table>	200	300	500	500	<ul style="list-style-type: none">Program progress reports	<ul style="list-style-type: none">Municipalities are in compliance with the Fiscal Responsibility Act and have borrowing capacity.				
200	300	500	500								

PROCUREMENT PLAN

Main procurement items for the program	Financing (%)		Tendering method	Year
	IDB	Local		
Infrastructure investment and equipment purchases (US\$150.7 million)	64	36	ICB (60%) LCB (40%)	2002-2005
Consulting services (US\$15 million)	25	75	ICB (30%) LCB (70%)	2002-2005

ICB international competitive bidding
LCB local competitive bidding